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**REVENUE ACT OF 1963**

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**HEARINGS**  
BEFORE THE  
**COMMITTEE ON FINANCE**  
**UNITED STATES SENATE**  
EIGHTY-EIGHTH CONGRESS

FIRST SESSION

ON

**H.R. 8363**

AN ACT TO AMEND THE INTERNAL REVENUE CODE OF 1954  
TO REDUCE INDIVIDUAL AND CORPORATE INCOME TAXES,  
TO MAKE CERTAIN STRUCTURAL CHANGES WITH RESPECT  
TO THE INCOME TAX, AND FOR OTHER PURPOSES

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OCTOBER 15, 16, 17, AND 18, 1963

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**PART 1**

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Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1963

24-532

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## REVENUE ACT OF 1963

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TUESDAY, OCTOBER 15, 1963

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; Long of Louisiana; Smathers, Anderson, Douglas, Gore, Talmadge, Ribicoff, Williams, Carlson, Bennett, Morton, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair recognizes the Senator from Tennessee, Senator Gore, in a matter of personal privilege.

Senator GORE. Mr. Chairman, I have two matters to bring up. First, I, along with, according to the press, other Senators, have received another four-page letter from Henry Ford and Stuart T. Saunders. I would like to inquire if either of these gentlemen has asked to testify on this bill.

The CHAIRMAN. Mrs. Springer?

Senator GORE. I would like to inquire if either Mr. Henry Ford or Mr. Stuart T. Saunders has asked to testify before this committee.

Mrs. SPRINGER. No, sir.

Senator GORE. Mr. Chairman, I respectfully suggest that both receive a courteous invitation to testify.

The CHAIRMAN. Very well.

Senator GORE. Mr. Chairman, the Democratic National Committee has dispatched a seven-page telegram to Democratic leaders in several counties in my State. The least I can say of it is that this is an attempt at political intimidation. I am not sure it is an attempt at a purge. But the man who sent this telegram is Mr. Bill Keel, who by telephone and otherwise has identified himself as an official of the Democratic National Committee. I would like to submit to the committee my request that he be invited to testify and explain by what authority he sent this telegram, to identify the accuracy or inaccuracy of the statements he makes, and which he has asked to be widely publicized in my State. If an invitation does not suffice, then I will ask the committee to subpoena Mr. Keel.

The CHAIRMAN. It will be done.

Senator GORE. I should like to put the text of this telegram in the record at this point, omitting the name of the recipient and the county of the recipient.

(The text of the telegram, with name of recipient and county deleted, follows:)

This is the suggested press release we discussed. Please have it copied and taken to all newspapers, radio and TV stations. The release follows:

"It is vital to 17,496 families in \* \* \* County who will receive an average personal income increase of \$436 a year that the tax cut be enacted now and made effective as of January 1," \* \* \* businessman and Democratic leader, said yesterday.

His statement:

"If we delay, as Senator Gore would have us do, we could be faced in short order with an urgent need for emergency measures.

"Emergency measures are makeshift measures resulting in patchwork effectiveness.

"If we act now time is our ally.

"If we delay we stand alone.

"Economists, financial experts, and businessmen across the Nation have endorsed the tax cut as a sound example of preventative medicine.

"We could be faced with the necessity for greater public spending. The most reasonable course is to permit the private sector of our economy to accelerate and that is what the tax reduction would do.

"Across the country the American public is overwhelmingly in favor of the tax cut. (A recent Gallup poll revealed 60 percent of those interviewed were for the tax cut.) Business favors it.

"I feel sure the people of \* \* \* County and Tennessee stand solidly behind the tax reduction.

"They know the high rate of unemployment. In 50 of our counties the unemployment rate ranges from 10 to 20 percent.

"A tax cut by January 1 is essential.

"What affects the national economy affects Tennessee \* \* \* County.

"What benefits the national economy also benefits us.

"A tax cut would benefit the 894,000 families in Tennessee in the following ways:

"Personal income in the State would increase by \$390 million a year.

"Increased State and local revenues from the Federal tax increase would increase State and local taxes in Tennessee by about \$25 million. This should ease the demands on the taxpayers by the State and local levels.

"Most of this money would be invested in the economy, spent for goods people then could afford to buy.

"This accelerated demand for products would result in the expansion of business and industry.

"This expansion would mean more jobs.

"More jobs means lower unemployment, higher employment. (There were 57,800 persons in Tennessee out of work at last report.)

"Higher employment means a healthier county, State and Nation, we cannot afford heel dragging.

"We cannot afford to hang back.

"A tax reduction now means we have faced the problems of the cyclical nature of recession and licked it.

"Unless the tax cut is enacted now and unless the national economy is stimulated, we run the risk of entering another recession cycle that would adversely affect the residents of \* \* \* County.

"Senator Albert Gore is making a most serious mistake in opposing the tax reduction. He should support it and do anything possible to speed its passage.

"The Senator's opposition is not only contrary to the best interests of the people of \* \* \* County but to Tennessee and the Nation as a whole.

"\* \* \* County and Tennessee are not islands unto themselves.

"We feel Senator Gore, if he is properly to reflect the genuine desires of the people of \* \* \* County, must realize it too.

"Now is the time for construction, not obstruction."

Senator GORE. I should like to read the first part of the telegram:

It is vital to the 17,496 families in \* \* \* County who will receive an average personal income increase of \$436 a year that the tax cut be enacted now.

Now, Mr. Chairman, it is a serious thing for the national committee of my party to say to the constituents of a county in my State that if this bill passes, they will receive \$436 a year increase in income.

I know that many people will receive a great increase in income after taxes, but I am not aware that—at least I have not been aware that the average family in a mountain county in Tennessee would receive a \$436 increase in income. This is just an example of what is contained in this seven-page telegram which attempts political intimidation of me and, so far as I know, might be the beginning of a purge.

So I would like to come to request that this man, Mr. Bill Keel, be invited to testify and give all the details back of this telegram, including any possible identification of the Treasury Department with it. If he does not come by invitation, then he should be subpoenaed.

The CHAIRMAN. That will be done.

Senator GORE. Thank you, Mr. Chairman.

Senator LONG. Mr. Chairman, I would just like that the record indicate that any effort to purge any Senator based on his vote, would not be correct; and my guess would be that the Democratic National Committee would give the Senator all the help that that committee is capable of giving him, assuming he is a Democratic nominee, which I am sure he will be. I would hope that the committee would not presume, nor the Senate presume, that the matter to which he is referring is anything more than an undiplomatic act by an individual.

I would doubt very much if the Democratic Committee would be responsible for the kind of conduct to which the Senator refers—that is, any kind of insinuation that dire consequences would flow from the Senate voting any other way than the way his conscience would dictate.

What he has introduced here is a wire, apparently, from a single individual. I take it that is not a wire from the National Committee.

Senator GORE. It is a wire from the office of the Democratic National Committee.

The CHAIRMAN. All that the Senator from Tennessee is asking is that he be brought before the committee, that he be invited to come and if he does not come by invitation, that he be subpoenaed. The chairman thinks that is a reasonable request.

Senator LONG. I have no objection to the request, Mr. Chairman. I simply have not seen the telegram, but I would not be willing to presume until I have had a chance to actually hear from those who do make policy in the National Committee that any sort of intimidation was intended.

Now, it may very well be that some individual member of the committee might draw his own conclusions and advocate something quite different from what the committee suggested to him. I just would not want the record to—I do not believe you can file charges against somebody without a bill of particulars and insofar as the Senator might want to make charges against this particular person, I do not believe he would want to conclude that the National Committee was responsible for this wire or that the chairman of the committee was responsible for this wire until he has had an opportunity to find out whether this is the thoughts of an individual or actually the views of the committee.

Senator TALMADGE. Mr. Chairman, I have had the privilege of reading the telegram addressed to the distinguished Senator from Tennessee.

I do not know what authority this gentleman had to send the telegram. He presumably spoke for his associates and those who employed him in the Democratic National Committee.

To read the telegram in its entirety, one can only draw the conclusion that it is an effort on the part of whoever sent the telegram and whoever was associated with him in that endeavor to bring political pressure and coercion on the Senator from Tennessee.

It has been my pleasure to know the Senator from Tennessee very well and I know that he does not respond to pressure very readily.

I do not believe the members of the Senate Finance Committee, individually or collectively, respond to pressure very readily. Of course, all of us are subject to persuasion. I do not believe an effort to go into the Senator's State with a mass volume of telegrams of that type and exhorting them to appeal to the press and the news media generally is the type of situation that ought to be condoned by this committee.

The CHAIRMAN. The committee will go into the matter thoroughly.

Senator MORTON. Mr. Chairman, just as a matter of information, I wonder where we can get four canaries for the four cats on this side of the aisle to swallow.

Senator GORE. We did not get that over here.

Senator MORTON. We are looking for four canaries for the four cats on this side of the aisle to swallow.

The CHAIRMAN. The Chair would like to make this statement:

The Senate Finance Committee today is starting public hearings on H.R. 8363, to reduce individual and corporate income taxes and make numerous other changes in the Federal Tax Code.

(H.R. 8363 is as follows:)

[H.R. 8363, 88th Cong., 1st sess.]

AN ACT To amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. DECLARATION BY CONGRESS.**

It is the sense of Congress that the tax reduction provided by this Act through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt. To further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective.

**SEC. 2. SHORT TITLE, ETC.**

(a) **SHORT TITLE.**--This Act may be cited as the "Revenue Act of 1963".

(b) **AMENDMENT OF 1954 CODE.**--Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.



# Title I—Reduction Of Income Tax Rates And Related Amendments

## PART I—INDIVIDUALS

### SEC. 111. REDUCTION OF TAX ON INDIVIDUALS.

(a) INDIVIDUALS OTHER THAN HEADS OF HOUSEHOLDS.—Subsection (a) of section 1 (relating to rates of tax on individuals other than heads of households) is amended to read as follows:

“(a) RATES OF TAX ON INDIVIDUALS.—

“(1) TAXABLE YEARS BEGINNING IN 1964.—In the case of a taxable year beginning on or after January 1, 1964, and before January 1, 1965, there is hereby imposed on the taxable income of every individual (other than a head of a household to whom subsection (b) applies) a tax determined in accordance with the following table:

“If the taxable income is:	The tax is:
Not over \$500-----	16% of the taxable income.
Over \$500 but not over \$1,000-----	\$80, plus 16.5% of excess over \$500.
Over \$1,000 but not over \$1,500-----	\$162.50, plus 17.5% of excess over \$1,000.
Over \$1,500 but not over \$2,000-----	\$250, plus 18% of excess over \$1,500.
Over \$2,000 but not over \$4,000-----	\$340, plus 20% of excess over \$2,000.
Over \$4,000 but not over \$6,000-----	\$740, plus 23.5% of excess over \$4,000.
Over \$6,000 but not over \$8,000-----	\$1,210, plus 27% of excess over \$6,000.
Over \$8,000 but not over \$10,000-----	\$1,750, plus 30.5% of excess over \$8,000.
Over \$10,000 but not over \$12,000-----	\$2,300, plus 34% of excess over \$10,000.
Over \$12,000 but not over \$14,000-----	\$2,940, plus 37.5% of excess over \$12,000.
Over \$14,000 but not over \$16,000-----	\$3,790, plus 41% of excess over \$14,000.
Over \$16,000 but not over \$18,000-----	\$4,610, plus 44.5% of excess over \$16,000.
Over \$18,000 but not over \$20,000-----	\$5,500, plus 47.5% of excess over \$18,000.
Over \$20,000 but not over \$22,000-----	\$6,450, plus 50.5% of excess over \$20,000.
Over \$22,000 but not over \$26,000-----	\$7,460, plus 53.5% of excess over \$22,000.
Over \$26,000 but not over \$32,000-----	\$9,600, plus 56% of excess over \$26,000.
Over \$32,000 but not over \$38,000-----	\$12,960, plus 58.5% of excess over \$32,000.
Over \$38,000 but not over \$44,000-----	\$16,470, plus 61% of excess over \$38,000.
Over \$44,000 but not over \$50,000-----	\$20,130, plus 63.5% of excess over \$44,000.
Over \$50,000 but not over \$60,000-----	\$23,940, plus 66% of excess over \$50,000.
Over \$60,000 but not over \$70,000-----	\$30,540, plus 68.5% of excess over \$60,000.
Over \$70,000 but not over \$80,000-----	\$37,300, plus 71% of excess over \$70,000.
Over \$80,000 but not over \$90,000-----	\$44,490, plus 73.5% of excess over \$80,000.

“If the taxable income is:	The tax is:
Over \$90,000 but not over \$100,000-----	\$51,840, plus 75% of excess over \$90,000.
Over \$100,000 but not over \$200,000-----	\$59,340, plus 76.5% of excess over \$100,000.
Over \$200,000-----	\$135,840, plus 77% of excess over \$200,000.

“(2) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—In the case of a taxable year beginning after December 31, 1963, there is hereby imposed on the taxable income of every individual (other than a head of a household to whom subsection (b) applies) a tax determined in accordance with the following table:

“If the taxable income is:	The tax is:
Not over \$500-----	14% of the taxable income.
Over \$500 but not over \$1,000-----	\$70, plus 15% of excess over \$500.
Over \$1,000 but not over \$1,500-----	\$145, plus 16% of excess over \$1,000.
Over \$1,500 but not over \$2,000-----	\$225, plus 17% of excess over \$1,500.
Over \$2,000 but not over \$4,000-----	\$310, plus 19% of excess over \$2,000.
Over \$4,000 but not over \$6,000-----	\$690, plus 22% of excess over \$4,000.
Over \$6,000 but not over \$8,000-----	\$1,130, plus 25% of excess over \$6,000.
Over \$8,000 but not over \$10,000-----	\$1,630, plus 28% of excess over \$8,000.
Over \$10,000 but not over \$12,000-----	\$2,190, plus 32% of excess over \$10,000.
Over \$12,000 but not over \$14,000-----	\$2,830, plus 36% of excess over \$12,000.
Over \$14,000 but not over \$16,000-----	\$3,550, plus 39% of excess over \$14,000.
Over \$16,000 but not over \$18,000-----	\$4,330, plus 42% of excess over \$16,000.
Over \$18,000 but not over \$20,000-----	\$5,170, plus 45% of excess over \$18,000.
Over \$20,000 but not over \$22,000-----	\$6,070, plus 48% of excess over \$20,000.
Over \$22,000 but not over \$26,000-----	\$7,030, plus 50% of excess over \$22,000.
Over \$26,000 but not over \$32,000-----	\$9,030, plus 53% of excess over \$26,000.
Over \$32,000 but not over \$38,000-----	\$12,210, plus 55% of excess over \$32,000.
Over \$38,000 but not over \$44,000-----	\$15,510, plus 58% of excess over \$38,000.

“If the taxable income is,	The tax is:
Over \$44,000 but not over \$50,000-----	\$18,990, plus 60% of excess over \$44,000.
Over \$50,000 but not over \$60,000-----	\$22,590, plus 62% of excess over \$50,000.
Over \$60,000 but not over \$70,000-----	\$28,790, plus 64% of excess over \$60,000.
Over \$70,000 but not over \$80,000-----	\$35,190, plus 66% of excess over \$70,000.
Over \$80,000 but not over \$90,000-----	\$41,790, plus 68% of excess over \$80,000.
Over \$90,000 but not over \$100,000-----	\$48,590, plus 69% of excess over \$90,000.
Over \$100,000-----	\$55,490, plus 70% of excess over \$100,000.”

(b) HEADS OF HOUSEHOLDS.—Paragraph (1) of section 1(b) (relating to rates of tax on heads of households) is amended to read as follows:

“(1) RATES OF TAX.—

“(A) TAXABLE YEARS BEGINNING IN 1964.—In the case of a taxable year beginning on or after January 1, 1964, and before January 1, 1965, there is hereby imposed on the taxable income of every individual who is the head of a household a tax determined in accordance with the following table:

“If the taxable income is:	The tax is:
Not over \$1,000-----	16% of the taxable income.
Over \$1,000 but not over \$2,000-----	\$160, plus 17.5% of excess over \$1,000.
Over \$2,000 but not over \$4,000-----	\$335, plus 19% of excess over \$2,000.
Over \$4,000 but not over \$6,000-----	\$715, plus 22% of excess over \$4,000.
Over \$6,000 but not over \$8,000-----	\$1,155, plus 23% of excess over \$6,000.
Over \$8,000 but not over \$10,000-----	\$1,615, plus 27% of excess over \$8,000.
Over \$10,000 but not over \$12,000-----	\$2,155, plus 29% of excess over \$10,000.
Over \$12,000 but not over \$14,000-----	\$2,735, plus 32% of excess over \$12,000.
“If the taxable income is:	The tax is:
Over \$14,000 but not over \$16,000-----	\$3,375, plus 34% of excess over \$14,000.
Over \$16,000 but not over \$18,000-----	\$4,055, plus 37.5% of excess over \$16,000.
Over \$18,000 but not over \$20,000-----	\$4,805, plus 39% of excess over \$18,000.
Over \$20,000 but not over \$22,000-----	\$5,585, plus 42.5% of excess over \$20,000.
Over \$22,000 but not over \$24,000-----	\$6,435, plus 43.5% of excess over \$22,000.
Over \$24,000 but not over \$26,000-----	\$7,305, plus 45.5% of excess over \$24,000.
Over \$26,000 but not over \$28,000-----	\$8,215, plus 47% of excess over \$26,000.
Over \$28,000 but not over \$32,000-----	\$9,155, plus 48.5% of excess over \$28,000.
Over \$32,000 but not over \$36,000-----	\$11,095, plus 51.5% of excess over \$32,000.
Over \$36,000 but not over \$38,000-----	\$13,155, plus 53% of excess over \$36,000.
Over \$38,000 but not over \$40,000-----	\$14,215, plus 54% of excess over \$38,000.
Over \$40,000 but not over \$44,000-----	\$15,295, plus 56% of excess over \$40,000.
Over \$44,000 but not over \$50,000-----	\$17,535, plus 58.5% of excess over \$44,000.
Over \$50,000 but not over \$52,000-----	\$21,045, plus 59.5% of excess over \$50,000.
Over \$52,000 but not over \$60,000-----	\$22,235, plus 61% of excess over \$52,000.
Over \$60,000 but not over \$64,000-----	\$27,115, plus 62% of excess over \$60,000.
Over \$64,000 but not over \$70,000-----	\$29,595, plus 63.5% of excess over \$64,000.
Over \$70,000 but not over \$78,000-----	\$33,405, plus 65% of excess over \$70,000.
Over \$76,000 but not over \$80,000-----	\$37,395, plus 66% of excess over \$76,000.
Over \$80,000 but not over \$88,000-----	\$39,945, plus 67% of excess over \$80,000.
Over \$88,000 but not over \$90,000-----	\$45,595, plus 69% of excess over \$88,000.
Over \$90,000 but not over \$100,000-----	\$46,685, plus 69.5% of excess over \$90,000.
Over \$100,000 but not over \$120,000-----	\$53,635, plus 71% of excess over \$100,000.
Over \$120,000 but not over \$140,000-----	\$67,835, plus 72.5% of excess over \$120,000.
Over \$140,000 but not over \$160,000-----	\$82,335, plus 74% of excess over \$140,000.
Over \$160,000 but not over \$180,000-----	\$97,135, plus 75% of excess over \$160,000.
Over \$180,000 but not over \$200,000-----	\$112,135, plus 75.5% of excess over \$180,000.
Over \$200,000-----	\$127,235, plus 77% of excess over \$200,000.

"(B) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—In the case of a taxable year beginning after December 31, 1964, there is hereby imposed on the taxable income of every individual who is the head of a household a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over \$1,000-----	14% of the taxable income.
Over \$1,000 but not over \$2,000-----	\$140, plus 16% of excess over \$1,000.
Over \$2,000 but not over \$4,000-----	\$300, plus 18% of excess over \$2,000.
Over \$4,000 but not over \$6,000-----	\$660, plus 20% of excess over \$4,000.
Over \$6,000 but not over \$8,000-----	\$1,060, plus 22% of excess over \$6,000.
Over \$8,000 but not over \$10,000-----	\$1,500, plus 25% of excess over \$8,000.
Over \$10,000 but not over \$12,000-----	\$2,000, plus 27% of excess over \$10,000.
Over \$12,000 but not over \$14,000-----	\$2,540, plus 31% of excess over \$12,000.
Over \$14,000 but not over \$16,000-----	\$3,160, plus 32% of excess over \$14,000.
Over \$16,000 but not over \$18,000-----	\$3,800, plus 35% of excess over \$16,000.
Over \$18,000 but not over \$20,000-----	\$4,500, plus 36% of excess over \$18,000.
Over \$20,000 but not over \$22,000-----	\$5,220, plus 40% of excess over \$20,000.
Over \$22,000 but not over \$24,000-----	\$6,020, plus 41% of excess over \$22,000.
Over \$24,000 but not over \$26,000-----	\$6,840, plus 43% of excess over \$24,000.
Over \$26,000 but not over \$28,000-----	\$7,700, plus 45% of excess over \$26,000.
Over \$28,000 but not over \$32,000-----	\$8,600, plus 46% of excess over \$28,000.
Over \$32,000 but not over \$36,000-----	\$10,440, plus 48% of excess over \$32,000.
Over \$36,000 but not over \$38,000-----	\$12,360, plus 50% of excess over \$36,000.
Over \$38,000 but not over \$40,000-----	\$13,360, plus 52% of excess over \$38,000.
Over \$40,000 but not over \$44,000-----	\$14,400, plus 53% of excess over \$40,000.
Over \$44,000 but not over \$50,000-----	\$16,520, plus 55% of excess over \$44,000.
Over \$50,000 but not over \$52,000-----	\$19,820, plus 56% of excess over \$50,000.

"If the taxable income is:	The tax is:
Over \$52,000 but not over \$64,000-----	\$20,940, plus 58% of excess over \$52,000.
Over \$64,000 but not over \$70,000-----	\$27,900, plus 59% of excess over \$64,000.
Over \$70,000 but not over \$76,000-----	\$31,440, plus 61% of excess over \$70,000.
Over \$76,000 but not over \$80,000-----	\$35,100, plus 62% of excess over \$76,000.
Over \$80,000 but not over \$88,000-----	\$37,580, plus 63% of excess over \$80,000.
Over \$88,000 but not over \$100,000-----	\$42,020, plus 64% of excess over \$88,000.
Over \$100,000 but not over \$120,000-----	\$50,300, plus 66% of excess over \$100,000.
Over \$120,000 but not over \$140,000-----	\$63,500, plus 67% of excess over \$120,000.
Over \$140,000 but not over \$160,000-----	\$76,900, plus 68% of excess over \$140,000.
Over \$160,000 but not over \$180,000-----	\$90,500, plus 69% of excess over \$160,000.
Over \$180,000-----	\$104,300, plus 70% of excess over \$180,000."

#### SEC. 112. MINIMUM STANDARD DEDUCTION.

(a) GENERAL RULE.—Section 141 (relating to standard deduction) is amended to read as follows:

#### "SEC. 141. STANDARD DEDUCTION.

"(a) STANDARD DEDUCTION.—Except as otherwise provided in this section, the standard deduction referred to in this title is the larger of the 10-percent standard deduction or the minimum standard deduction. The standard deduction shall not exceed \$1,000, except that in the case of a separate return by a married individual the standard deduction shall not exceed \$500.

"(b) **TEN-PERCENT STANDARD DEDUCTION.**—The 10-percent standard deduction is an amount equal to 10 percent of the adjusted gross income.

"(c) **MINIMUM STANDARD DEDUCTION.**—The minimum standard deduction is an amount equal to the sum of—

(1) \$100, multiplied by the number of exemptions allowed for the taxable year as a deduction under section 151, plus

(2) (A) \$200, in the case of a joint return of a husband and wife under section 6013,

(B) \$200, in the case of a return of an individual who is not married, or

(C) \$100, in the case of a separate return by a married individual.

"(d) **MARRIED INDIVIDUALS FILING SEPARATE RETURNS.**—Notwithstanding subsection (a)—

(1) The minimum standard deduction shall not apply in the case of a separate return by a married individual if the tax of the other spouse is determined with regard to the 10-percent standard deduction.

(2) A married individual filing a separate return may, if the minimum standard deduction is less than the 10-percent standard deduction, and if the minimum standard deduction of his spouse is greater than the 10-percent standard deduction of such spouse, elect (under regulations prescribed by the Secretary or his delegate) to have his tax determined with regard to the minimum standard deduction in lieu of being determined with regard to the 10-percent standard deduction."

(b) **AMENDMENT OF SECTION 2.**—The second sentence of section 2(a) (relating to tax in case of joint return or return of surviving spouse) is amended by striking out "and section 3" and inserting in lieu thereof ", section 3, and section 141".

(c) **AMENDMENTS OF SECTION 144.**—

(1) The first sentence of section 144(b) (relating to change of election of standard deduction) is amended to read as follows: "Under regulations prescribed by the Secretary or his delegate, a change of election with respect to the standard deduction for any taxable year may be made after the filing of the return for such year."

(2) Section 144 is amended by adding at the end thereof the following new subsection:

"(c) **CHANGE OF ELECTION DEFINED.**—For purposes of this title, the term 'change of election with respect to the standard deduction' means—

(1) a change of an election to take (or not to take) the standard deduction;

(2) a change of an election to pay (or not to pay) the tax under section 3; or

(3) a change of an election under section 141(d)(2)."

(d) **CONFORMING AMENDMENTS.**—

(1) Subparagraph (A) of section 6212(e)(2) (relating to cross references) is amended by striking out "to take" and inserting in lieu thereof "with respect to the".

(2) Paragraph (3) of section 6504 (relating to cross references) is amended by striking out "to take" and inserting in lieu thereof "with respect to the".

#### SEC. 113. RELATED AMENDMENTS.

(a) **RETIREMENT INCOME CREDIT.**—Section 37(a) (relating to credit against tax for retirement income) is amended by striking out "an amount equal to the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d)), multiplied by the rate provided in section 1 for the first \$2,000 of taxable income;" and inserting in lieu thereof "an amount equal to 15 percent of the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d));".

(b) **TAX ON NONRESIDENT ALIEN INDIVIDUALS.**—Section 871 (relating to tax on nonresident alien individuals) is amended—

(1) By striking out "is more than \$15,400, except that—" in subsection

(b) and inserting in lieu thereof "is more than \$10,000 in the case of a taxable year beginning in 1964 or more than \$21,200 in the case of a taxable year beginning after 1964, except that—";

(2) By striking out the heading to subsection (a) and inserting in lieu thereof the following:

"(a) NO UNITED STATES BUSINESS—30 PERCENT TAX.—".

(3) By striking out the heading of subsection (b) and inserting in lieu thereof the following:

"(b) NO UNITED STATES BUSINESS—REGULAR TAX.—".

**SEC. 114. CROSS REFERENCES TO TAX TABLES, ETC.**

(1) For optional tax if adjusted gross income at less than \$5,000, see section 301 of this Act.

(2) For income tax collected at source, see section 302 of this Act.

**PART II—CORPORATIONS**

**SEC. 121. REDUCTION OF TAX ON CORPORATIONS.**

Section 11 (relating to tax on corporations) is amended to read as follows:

**"SEC. 11. TAX IMPOSED.**

"(a) **CORPORATIONS IN GENERAL.**—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

"(b) **NORMAL TAX.**—The normal tax is equal to the following percentage of the taxable income:

"(1) 30 percent, in the case of a taxable year beginning before January 1, 1964, and

"(2) 22 percent, in the case of a taxable year beginning after December 31, 1963.

"(c) **SURTAZ.**—The surtax is equal to the following percentage of the amount by which the taxable income exceeds the surtax exemption for the taxable year:

"(1) 22 percent, in the case of a taxable year beginning before January 1, 1961,

"(2) 28 percent, in the case of a taxable year beginning after December 31, 1963, and before January 1, 1965, and

"(3) 26 percent, in the case of a taxable year beginning after December 31, 1961.

"(d) **SURTAZ EXEMPTION.**—For purposes of this subtitle, the surtax exemption for any taxable year is \$25,000 or the amount determined under section 1561 (relating to surtax exemptions in case of certain controlled corporations).

"(e) **EXCEPTIONS.**—Subsection (a) shall not apply to a corporation subject to a tax imposed by—

"(1) section 594 (relating to mutual savings banks conducting life insurance business),

"(2) subchapter L (sec. 801 and following, relating to insurance companies),

"(3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts), or

"(4) section 881(a) (relating to foreign corporations not engaged in business in United States)."

**SEC. 122. CURRENT TAX PAYMENTS BY CORPORATIONS.**

(a) **INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.**—Section 6154 (relating to installment payments of estimated income tax by corporations) is amended to read as follows:

**"SEC. 6154. INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.**

"(a) AMOUNT AND TIME FOR PAYMENT OF EACH INSTALLMENT.—The amount of estimated tax (as defined in section 6016(b)) with respect to which a declaration is required under section 6016 shall be paid as follows:

"(1) PAYMENT IN 4 INSTALLMENTS.—If the declaration is filed on or before the 15th day of the 4th month of the taxable year, the estimated tax shall be paid in 4 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
1964.....	1	1	25	25
1965.....	4	4	25	25
1966.....	0	0	25	25
1967.....	14	14	25	25
1968.....	10	10	25	25
1969.....	22	22	25	25
1970 or any subsequent year.....	25	25	25	25

"(2) PAYMENT IN 3 INSTALLMENTS.—If the declaration is filed after the 15th day of the 4th month and not after the 15th day of the 6th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 4th month, the estimated tax shall be paid in 3 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—		
	6th month	9th month	12th month
1964.....	13½	25½	25½
1965.....	5½	20½	26½
1966.....	12	28	28
1967.....	18½	20½	20½
1968.....	12	25½	31½
1969.....	20½	32½	32½
1970 or any subsequent year.....	33½	33½	33½

"(3) PAYMENT IN 2 INSTALLMENTS.—If the declaration of estimated tax is filed after the 15th day of the 6th month and not after the 15th day of the 9th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 6th month, the estimated tax shall be paid in 2 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—	
	9th month	12th month
1964.....	26	26
1965.....	29	29
1966.....	34	34
1967.....	39	39
1968.....	44	44
1969.....	47	47
1970 or any subsequent year.....	60	60

"(4) PAYMENT IN 1 INSTALLMENT.—If the declaration of estimated tax is filed after the 15th day of the 9th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 9th month, the estimated tax shall be paid in 1 installment. The amount and time for payment of the installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the 12th month
1964.....	52
1965.....	58
1966.....	68
1967.....	78
1968.....	84
1969.....	91
1970 or any subsequent year.....	100

"(5) LATE FILING.—If the declaration is filed after the time prescribed in section 6074(a) (determined without regard to any extension of time for filing the declaration under section 6081), paragraphs (2), (3), and (4) of this subsection shall not apply, and there shall be paid at the time of such filing all installments of estimated tax which would have been payable on or before such time if the declaration had been filed within the time prescribed in section 6074(a), and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been so filed.

"(b) AMENDMENT OF DECLARATION.—If any amendment of a declaration is filed, the amount of each remaining installment (if any) shall be the amount which would have been payable if the new estimate had been made when the first estimate for the taxable year was made, increased or decreased (as the case may be), by the amount computed by dividing—

"(1) the difference between (A) the amount estimated of tax required to be paid before the date on which the amendment is made, and (B) the amount of estimated tax which would have been required to be paid before such date if the new estimate had been made when the first estimate was made, by

"(2) the number of installments remaining to be paid on or after the date on which the amendment is made.

"(c) APPLICATION TO SHORT TAXABLE YEAR.—The application of this section to taxable years of less than 12 months shall be in accordance with regulations prescribed by the Secretary or his delegate.

"(d) INSTALLMENTS PAID IN ADVANCE.—At the election of the corporation, any installment of the estimated tax may be paid before the date prescribed for its payment."

(b) TIME FOR FILING DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6074 (relating to time for filing declarations of estimated income tax by corporations) is amended to read as follows:

**"SEC. 6074. TIME FOR FILING DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.**

"(a) GENERAL RULE.—The declaration of estimated tax required of corporations by section 6016 shall be filed as follows:

"If the requirements of section 6016 are first met—	The declaration shall be filed on or before—
before the 1st day of the 4th month of the taxable year.....	the 15th day of the 4th month of the taxable year.
after the last day of the 3d month and before the 1st day of the 6th month of the taxable year.	the 15th day of the 6th month of the taxable year.
after the last day of the 5th month and before the 1st day of the 9th month of the taxable year.	the 15th day of the 9th month of the taxable year.
after the last day of the 8th month and before the 1st day of the 12th month of the taxable year.	the 15th day of the 12th month of the taxable year.

"(b) AMENDMENT.—An amendment of a declaration may be filed in any interval between installment dates prescribed for the taxable year, but only one amendment may be filed in each such interval.

"(c) SHORT TAXABLE YEAR.—The application of this section to taxable years of less than 12 months shall be in accordance with regulations prescribed by the Secretary or his delegate."

(c) FAILURE BY CORPORATIONS TO PAY ESTIMATED INCOME TAX.—

(1) The last sentence of section 6655(c) (2) (relating to period of underpayment) is amended to read as follows: "For purposes of this paragraph, a payment of estimated tax on any installment date shall be considered a payment of any previous underpayment only to the extent such payment exceeds the amount of the installment determined under subsection (b) (1) for such installment date."

(2) Paragraph (3) of section 6655(d) (relating to exception) is amended to read as follows:

"(3) (A) An amount equal to 70 percent of the tax for the taxable year computed by placing on an annualized basis the taxable income:

"(i) for the first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month,

"(ii) for the first 3 months or for the first 5 months of the taxable year, in the case of the installment required to be paid in the 6th month,

"(iii) for the first 6 months or for the first 8 months of the taxable year in the case of the installment required to be paid in the 9th month, and

"(iv) for the first 9 months or for the first 11 months of the taxable year, in the case of the installment required to be paid in the 12th month of the taxable year.

"(B) For purposes of this paragraph, the taxable income shall be placed on an annualized basis by—

"(i) multiplying by 12 the taxable income referred to in subparagraph (A), and

"(ii) dividing the resulting amount by the number of months in the taxable year (3, 5, 6, 8, 9, or 11, as the case may be) referred to in subparagraph (A)."

(d) TECHNICAL AMENDMENT.—Section 6016(f) (relating to declarations of estimated income tax by corporations) is amended to read as follows:

"(f) CROSS REFERENCE.—

"For provisions relating to the number of amendments which may be filed, see section 6071(b)."

SEC. 123. RELATED AMENDMENTS.

(a) TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, ETC.)—

(1) Subsection (a) of section 821 (relating to imposition of tax) is amended to read as follows:

"(a) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year beginning after December 31, 1963, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

"(1) NORMAL TAX.—A normal tax of 22 percent of the mutual insurance company taxable income, or 44 percent of the amount by which such taxable income exceeds \$6,000, whichever is the lesser; plus

"(2) SURTAX.—A surtax on the mutual insurance company taxable income computed as provided in section 11(c) as though the mutual insurance company taxable income were the taxable income referred to in section 11(c)."

(2) Paragraph (1) of section 821(c) (relating to alternative tax for certain small companies) is amended to read as follows:

"(1) IMPOSITION OF TAX.—In the case of taxable years beginning after December 31, 1963, there is hereby imposed for each taxable year on the income of each mutual insurance company to which this subsection applies a tax (which shall be in lieu of the tax imposed by subsection (a)) computed as follows:

"(A) NORMAL TAX.—A normal tax of 22 percent of the taxable investment income, or 44 percent of the amount by which such taxable income exceeds \$3,000, whichever is the lesser; plus



"(B) SURTAX.—A surtax on the taxable investment income computed as provided in section 11(c) as though the taxable investment income were the taxable income referred to in section 11(c)."

(b) RECEIPT OF MINIMUM DISTRIBUTIONS BY DOMESTIC CORPORATIONS.—Subsection (b) of section 963 (relating to receipt of minimum distributions by domestic corporations) is amended to read as follows:

"(b) MINIMUM DISTRIBUTION.—For purposes of this section, a minimum distribution with respect to the earnings and profits for the taxable year of any United States shareholder, be its pro rata share of an amount determined in accordance with whichever of the following tables applies to the taxable year:

"(1) TAXABLE YEARS BEGINNING IN 1963.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10.....	90
10 or over but less than 20.....	86
20 or over but less than 28.....	82
28 or over but less than 34.....	75
34 or over but less than 39.....	68
39 or over but less than 42.....	55
42 or over but less than 44.....	40
44 or over but less than 46.....	27
46 or over but less than 47.....	14
47 or over.....	0

"(2) TAXABLE YEARS BEGINNING IN 1964.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10.....	87
10 or over but less than 19.....	83
19 or over but less than 27.....	79
27 or over but less than 33.....	72
33 or over but less than 37.....	45
37 or over but less than 40.....	53
40 or over but less than 42.....	38
42 or over but less than 44.....	26
44 or over but less than 45.....	13
45 or over.....	0

"(3) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 9.....	83
9 or over but less than 18.....	79
18 or over but less than 26.....	76
26 or over but less than 32.....	69
32 or over but less than 36.....	63
36 or over but less than 39.....	51
39 or over but less than 41.....	37
41 or over but less than 42.....	25
42 or over but less than 43.....	13
43 or over.....	0"

(c) AMENDMENT OF SECTION 242.—Section 242(a) (relating to deduction for partially tax-exempt interest) is amended by adding at the end thereof the following new sentence: "No deduction shall be allowed under this section for purposes of any surtax imposed by this subtitle."

### PART III—EFFECTIVE DATES

#### SEC. 131. GENERAL RULE.

Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by parts I and II of this title shall apply with respect to taxable years beginning after December 31, 1963.

#### SEC. 132. FISCAL YEAR TAXPAYERS.

Effective with respect to taxable years ending after December 31, 1963, subsection (d) of section 21 (relating to effect of changes in rates during a taxable year) is amended to read as follows:

"(d) CHANGES MADE BY REVENUE ACT OF 1963.—

"(1) INDIVIDUALS.—In applying subsection (a) to the taxable year of an individual beginning in 1963 and ending in 1964—

"(A) the rate of tax for the period on and after January 1, 1964, shall be applied to the taxable income determined as if part IV of subchapter B (relating to standard deduction for individuals), as amended by the Revenue Act of 1963, applied to taxable years ending after December 31, 1963, and

"(B) section 4 (relating to rules for optional tax), as amended by such Act, shall be applied to taxable years ending after December 31, 1963.

In applying subsection (a) to a taxable year of an individual beginning in 1963 and ending in 1964, or beginning in 1964 and ending in 1965, the change in the tax imposed under section 3 shall be treated as a change in a rate of tax.

"(2) CORPORATIONS.—In applying subsection (a) to a taxable year of a corporation beginning in 1963 and ending in 1964, if—

"(A) the surtax exemption of such corporation for such taxable year is less than \$25,000 by reason of the application of section 1501 (relating to surtax exemptions in case of certain controlled corporations), or

"(B) an additional tax is imposed on the taxable income of such corporation for such taxable year by section 1502(b) (relating to additional tax in case of component members of controlled groups which elect multiple surtax exemptions),

the change in the surtax exemption, or the imposition of such additional tax, shall be treated as a change in a rate of tax taking effect on January 1, 1964."

## Title II—Structural Changes

### SEC. 201. DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) REDUCTION OF 4 PERCENT CREDIT TO 2 PERCENT CREDIT FOR CALENDAR YEAR 1964.—

(1) GENERAL RULE.—Section 34(a) (relating to general rule for credit for dividends received) is amended by striking out "an amount equal to 4 percent of the dividends which are received after July 31, 1954, from domestic corporations and are included in gross income" and inserting in lieu thereof: "an amount equal to the following percentage of the dividends which are received from domestic corporations and are included in gross income:

"(1) 4 percent of the amount of such dividends which are received before January 1, 1964, and

"(2) 2 percent of the amount of such dividends which are received during the calendar year 1964."

(2) LIMITATIONS.—Section 34(b) (2) (relating to limitations on amount of credit) is amended—

(A) by inserting ", or beginning after December 31, 1963" after "1955" at the end of subparagraph (A), and

(B) by inserting ", and beginning before January 1, 1964" after "1954" at the end of subparagraph (B).

(b) REPEAL OF CREDIT FOR DIVIDENDS RECEIVED BY INDIVIDUALS.—Effective with respect to dividends received after December 31, 1964, section 34 (relating to dividends received by individuals) is hereby repealed.

(c) DOUBLING OF AMOUNT OF PARTIAL EXCLUSION FROM GROSS INCOME OF DIVIDENDS RECEIVED BY INDIVIDUALS.—Section 116(a) (relating to partial exclusion from gross income of dividends received by individuals) is amended by striking out "\$50" each place it appears and inserting in lieu thereof "\$100".

(d) CONFORMING AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking out

"Sec. 34. Dividends received by individuals."

(2) Section 35(b) (1) is amended by striking out "the sum of the credits allowable under sections 33 and 34" and inserting in lieu thereof "the credit allowable under section 33".

(3) Section 37(a) is amended by striking out "section 34 (relating to credit for dividends received by individuals)".

(4) Section 40(a) (3) is amended by striking out subparagraph (B), and by redesignating subparagraphs (C) and (D) as "(B)" and "(C)", respectively.

- (5) Section 584(c) (2) is amended by striking out "section 34 or".  
 (6) (A) Section 642(a) is amended by striking out paragraph (3);  
 (B) Section 642(1) is amended to read as follows:

"(1) CROSS REFERENCES.—

"(1) For disallowance of standard deduction in case of estates and trusts, see section 142(b) (4).

"(2) For special rule for determining the time of receipt of dividends by a beneficiary under section 652 or 662, see section 116(c) (3)."

(C) Section 116(c) is amended by adding at the end thereof the following new paragraph:

"(3) The amount of dividends properly allocable to a beneficiary under section 652 or 662 shall be deemed to have been received by the beneficiary ratably on the same date that the dividends were received by the estate or trust."

(7) Section 702(a) (5) is amended by striking out "a credit under section 34," and the comma after "section 116".

(8) Section 854(a) is amended by striking out "section 34(a) (relating to credit for dividends received by individuals)," and the comma after "section 116 (relating to an exclusion for dividends received by individuals)".

(9) Section 854(b) (1) is amended by striking out "the credit under section 34(a)," and the comma after "section 116".

(10) Section 854(b) (2) is amended by striking out "the credit under section 34," and the comma after "section 116".

(11) Section 857(c) is amended by striking out "section 34(a) (relating to credit for dividends received by individuals)," and the comma after "section 116 (relating to an exclusion for dividends received by individuals)".

(12) Section 871(b) is amended by striking out "the sum of the credits under sections 34 and 35" and inserting in lieu thereof "the credit under section 35".

(13) Section 1375(b) is amended by striking out "section 34," and the comma after "section 37".

(14) Section 6014(a) is amended by striking out "34 or".

(e) EFFECTIVE DATES.—The amendments made by subsection (a) shall apply with respect to taxable years ending after December 31, 1963. The amendment made by subsection (b) shall apply with respect to taxable years ending after December 31, 1964. The amendment made by subsection (c) shall apply with respect to taxable years beginning after December 31, 1963. The amendments made by subsection (d) shall apply with respect to dividends received after December 31, 1964, in taxable years ending after such date.

**SEC. 202. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT; OTHER PROVISIONS RELATING TO INVESTMENT CREDIT.**

(a) REPEAL OF REQUIREMENT THAT BASIS BE REDUCED.—

(1) IN GENERAL.—Subsection (g) of section 48 (requiring that the basis of section 38 property be reduced by 7 percent of the qualified investment) is hereby repealed.

(2) INCREASE IN BASIS OF PROPERTY PLACED IN SERVICE BEFORE JULY 1, 1963.—

(A) The basis of any section 38 property (as defined in section 48(a) of the Internal Revenue Code of 1954) placed in service before July 1, 1963, shall be increased, under regulations prescribed by the Secretary of the Treasury or his delegate, by an amount equal to 7 percent of the qualified investment with respect to such property under section 46(c) of the Internal Revenue Code of 1954. If there has been any increase with respect to such property under section 48(g) (2) of such Code, the increase under the preceding sentence shall be appropriately reduced therefor.

(B) If a lessor made the election provided by section 48(d) of the Internal Revenue Code of 1954 with respect to property placed in service before July 1, 1963—

(1) subparagraph (A) shall not apply with respect to such property, but

(H) under regulations prescribed by the Secretary of the Treasury or his delegate, the deductions otherwise allowable under section 162 of such Code to the lessee for amounts paid to the lessor under the lease (or, if such lessee has purchased such property, the basis of such property) shall be adjusted in a manner consistent with subparagraph (A).

(C) The adjustments under this paragraph shall be made as of the first day of the taxpayer's first taxable year which begins after June 30, 1963.

**(3) CONFORMING AMENDMENTS.—**

(A) The last sentence of section 48(d) (relating to certain leased property) is hereby repealed.

(B) Section 181 (relating to deduction for certain unused investment credit) is hereby repealed.

(C) Section 1016(a)(10) (relating to adjustments to basis) is amended to read as follows:

"(10) to the extent provided in section 48(g) and in section 202(a)(2) of the Revenue Act of 1963, in the case of property which is or has been section 38 property (as defined in section 48(a));"

(D) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the following:

"Sec. 181. Deduction for certain unused investment credit."

**(4) EFFECTIVE DATE.—**Paragraphs (1) and (3) of this subsection shall apply—

(A) in the case of property placed in service after June 30, 1963, with respect to taxable years ending after such date, and

(B) in the case of property placed in service before July 1, 1963, with respect to taxable years beginning after June 30, 1963.

**(b) BASIS OF CERTAIN LEASED PROPERTY TO LESSEE.—**Paragraphs (1) and (2) of section 48(d) (relating to certain leased property) are amended to read as follows:

"(1) except as provided in paragraph (2), the fair market value of such property, or

"(2) if such property is leased by a corporation which is a member of an affiliated group (within the meaning of section 40(a)(5)) to another corporation which is a member of the same affiliated group, the basis of such property to the lessor."

**(c) TREATMENT OF ELEVATORS AND ESCALATORS FOR PURPOSES OF THE INVESTMENT CREDIT.—**Section 48(a)(1) (relating to section 38 property) is amended—

(1) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or"; and

(2) by adding after subparagraph (B) the following new subparagraph:

"(C) elevators and escalators, but only if—

"(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

"(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date."

**(d) TREATMENT OF ELEVATORS AND ESCALATORS FOR PURPOSES OF SECTION 1245.—**Section 1245(a) (relating to gain from dispositions of certain depreciable property) is amended—

(1) by striking out so much of paragraph (2) as precedes the second sentence thereof and inserting in lieu thereof the following:

"(2) RECOMPUTED BASIS.—For purposes of this section, the term 'recomputed basis' means—

"(A) with respect to any property referred to in paragraph (3) (A) or (B), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after December 31, 1961, or

"(B) with respect to any property referred to in paragraph (3) (C), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after June 30, 1963.

reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation, or for amortization under section 168.":

(2) by striking out the period at the end of paragraph (3) (B) and inserting in lieu thereof ", or"; and

(3) by adding at the end of paragraph (3) the following new subparagraph:

"(C) an elevator or an escalator."

(e) **TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES.**—It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use—

(1) in the case of public utility property (as defined in section 40(c) (3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code, or

(2) in the case of any other property, any credit against tax allowed by section 38 of such Code, to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method.

(f) **EFFECTIVE DATES.**—

(1) The amendments made by subsection (b) shall apply with respect to property possession of which is transferred to a lessee on or after the date of enactment of this Act.

(2) The amendments made by subsection (c) shall apply with respect to taxable years ending after June 30, 1963.

(3) The amendments made by subsection (d) shall apply with respect to dispositions after December 31, 1963, in taxable years ending after such date.

#### **SEC. 203. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES.**

(a) **INCLUSION IN INCOME.**—

(1) Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

#### **"SEC. 79. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES.**

"(a) **GENERAL RULE.**—There shall be included in the gross income of an employee for the taxable year an amount equal to the cost of group-term life insurance on his life provided for part or all of such year under a policy (or policies) carried directly or indirectly by his employer (or employers); but only to the extent that such cost exceeds the sum of—

"(1) the cost of so much of such insurance as does not exceed \$30,000 of protection, and

"(2) the amount (if any) paid by the employee toward the purchase of such insurance.

"(b) **EXCEPTIONS.**—Subsection (a) shall not apply to—

"(1) the cost of group-term life insurance on the life of an individual which is provided under a policy carried directly or indirectly by an employer after such individual has terminated his employment with such employer and either has reached the retirement age with respect to such employer or is disabled (within the meaning of paragraph (3) of section 213(g), determined without regard to paragraph (4) thereof),

(2) the cost of any portion of the group-term life insurance on the life of an employee provided during part or all of the taxable year of the employee under which—

"(A) the employer is directly or indirectly the beneficiary, or

"(B) a person described in section 170(c) is the sole beneficiary, for the entire period during such taxable year for which the employee receives such insurance, and

"(3) the cost of any group-term life insurance which is provided under a contract to which section 72(m) (3) applies.

"(c) **DETERMINATION OF COST OF INSURANCE.**—

"(1) **UNIFORM PREMIUM TABLE METHOD.**—For purposes of this section and chapter 24, the cost of group-term life insurance on the life of an employee provided during any period shall be determined on the basis of uniform

premiums (computed on the basis of 5-year age brackets) prescribed by regulations by the Secretary or his delegate.

"(2) **POLICY COST METHOD.**—If the employer so elects (at such time and in such manner as the Secretary or his delegate prescribes) with respect to any employee for any period, the cost of group-term life insurance on the life of such employee shall (in lieu of being determined under paragraph (1)) be determined on the basis of the average premium cost under the policy for the ages included within the age bracket which would be applicable to such employee under paragraph (1). The preceding sentence shall not apply for purposes of determining the cost of insurance provided under a policy if the premium on such policy is not computed on the basis of the cost of such insurance at the ages (or at the age brackets applicable under paragraph (1)) of the individuals comprising the group.

"(3) **EMPLOYED INDIVIDUALS OVER AGE 64.**—In the case of an employee who has attained age 64, the cost determined under paragraph (1) or (2), as the case may be, shall not exceed the cost which would be determined under such paragraph with respect to such individual if he were age 63."

(2) The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end thereof the following:

"Sec. 79. Group-term life insurance purchased for employees."

(3) Section 7701(a) (20) (defining employee) is amended by striking out "For the purpose of applying the provisions of sections 104" and inserting in lieu thereof "For the purpose of applying the provisions of sections 79 and 218 with respect to group-term life insurance purchased for employees, for the purpose of applying the provisions of sections 104".

(b) **CERTAIN CONTRIBUTIONS BY EMPLOYEES FOR GROUP-TERM LIFE INSURANCE.**—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by inserting after section 217 the following new section:

**"SEC. 218. CERTAIN CONTRIBUTIONS BY EMPLOYEES FOR GROUP-TERM LIFE INSURANCE.**

"In the case of an employee on whose life group-term life insurance in excess of \$30,000 is provided for part or all of the taxable year under a policy (or policies) carried directly or indirectly by his employer (or employers), there shall be allowed as a deduction for such taxable year an amount equal to the excess (if any) of—

"(1) the amount paid by the employee toward the purchase of such insurance in excess of \$30,000, over

"(2) the cost (determined in the manner provided by paragraph (1) of section 79(c), without regard to paragraph (3) thereof) of such insurance in excess of \$30,000.

For purposes of this section, there shall not be taken into account any insurance the cost of which is excepted from the application of subsection (a) of section 79 by subsection (b) thereof."

(c) **WITHHOLDING.**—Section 3401(a) (relating to definition of wages) is amended by striking out the period at the end of paragraph (13) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(14) in the form of group-term life insurance on the life of an employee, but only to the extent the cost of such insurance is not includible in the employee's gross income under section 79(a). For purposes of this paragraph, the extent to which the cost of group-term life insurance is includible in the employee's gross income under section 79(a) shall be determined as if the employer were the only employer paying such employee remuneration in the form of such insurance; or".

(d) **EFFECTIVE DATES.**—The amendments made by subsections (a) and (b) shall apply with respect to group-term life insurance provided after December 31, 1963, in taxable years ending after such date. The amendments made by subsection (c) shall apply with respect to remuneration paid after December 31, 1963, in the form of group-term life insurance provided after such date.

**SEC. 204. INCLUSION IN GROSS INCOME OF REIMBURSED MEDICAL EXPENSES TO THE EXTENT THAT THE REIMBURSEMENT EXCEEDS THE EXPENSES.**

(a) **GENERAL RULE.**—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

**"SEC. 80. REIMBURSEMENT OF MEDICAL EXPENSES IN EXCESS OF SUCH EXPENSES.**

"Notwithstanding any other provision of this subchapter, amounts received through accident or health insurance for medical expenses shall be included in gross income to the extent the aggregate of such amounts received for any personal injury or sickness exceeds the aggregate amount of the medical expenses incurred by the taxpayer for such personal injury or sickness. For purposes of this section, the term 'medical expenses' means expenses for medical care as defined in section 213(c), except that it does not include amounts paid for accident or health insurance."

(b) **CLERICAL AMENDMENT.**—The table of sections for such part II is amended by adding at the end thereof the following:

"Sec. 80. Reimbursement of medical expenses in excess of such expenses."

(c) **TECHNICAL AMENDMENT.**—Subsection (c) of section 105 (relating to the definition of accident and health plans) is amended by striking out "this section" and inserting in lieu thereof "this section, section 80."

(d) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1963.

**SEC. 205. AMOUNTS RECEIVED UNDER WAGE CONTINUATION PLANS.**

(a) **WAGE CONTINUATION PLANS.**—The second sentence of section 105(d) (relating to wage continuation plans) is amended to read as follows: "The preceding sentence shall not apply to amounts attributable to the first 30 calendar days in such period."

(b) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall apply to amounts attributable to periods of absence commencing after December 31, 1963.

**SEC. 206. EXCLUSION FROM GROSS INCOME OF GAIN ON SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 65.**

(a) **IN GENERAL.**—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 121 as section 122 and by inserting before such section the following new section:

**"SEC. 121. GAIN FROM SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 65.**

"(a) **GENERAL RULE.**—At the election of the taxpayer gross income does not include gain from the sale or exchange of property if—

"(1) the taxpayer has attained the age of 65 before the date of such sale or exchange, and

"(2) during the 8-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more.

"(b) **LIMITATIONS.**—

"(1) **WHERE ADJUSTED SALES PRICE EXCEEDS \$20,000.**—If the adjusted sales price of the property sold or exchanged exceeds \$20,000, subsection (a) shall apply to that portion of the gain which bears the same ratio to the total amount of such gain as \$20,000 bears to such adjusted sales price. For purposes of the preceding sentence, the term 'adjusted sales price' has the meaning assigned to such term by section 1034(b)(1) (determined without regard to subsection (d)(7) of this section).

"(2) **APPLICATION TO ONLY ONE SALE OR EXCHANGE.**—Subsection (a) shall not apply to any sale or exchange by the taxpayer if an election by the taxpayer or his spouse under subsection (a) with respect to any other sale or exchange is in effect.

"(c) **ELECTION.**—An election under subsection (a) may be made or revoked at any time before the expiration of the period for making a claim for credit or refund of the tax imposed by this chapter for the taxable year in which the sale or exchange occurred, and shall be made or revoked in such manner as the Secretary or his delegate shall by regulations prescribe. In the case of a taxpayer who is married, an election under subsection (a) or a revocation thereof may be made only if his spouse joins in such election or revocation.

**"(d) SPECIAL RULES.—**

**"(1) PROPERTY HELD JOINTLY BY HUSBAND AND WIFE.—**For purposes of this section, if—

"(A) property is held by a husband and wife as joint tenants, tenants by the entirety, or community property,

"(B) such husband and wife make a joint return under section 6013 for the taxable year of the sale or exchange, and

"(C) one spouse satisfies the age, holding, and use requirements of subsection (a) with respect to such property, then both husband and wife shall be treated as satisfying the age, holding, and use requirements of subsection (a) with respect to such property.

**"(2) PROPERTY OF DECEASED SPOUSE.—**For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, if—

"(A) the deceased spouse (during the 8-year period ending on the date of the sale or exchange) satisfied the holding and use requirements of subsection (a) (2) with respect to such property, and

"(B) no election by the deceased spouse under subsection (a) is in effect with respect to a prior sale or exchange, then such individual shall be treated as satisfying the holding and use requirements of subsection (a) (2) with respect to such property.

**"(3) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—**For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

"(A) the holding requirements of subsection (a) (2) shall be applied to the holding of such stock, and

"(B) the use requirements of subsection (a) (2) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

**"(4) INVOLUNTARY CONVERSIONS.—**For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

**"(5) PROPERTY USED IN PART AS PRINCIPAL RESIDENCE.—**In the case of property only a portion of which, during the 8-year period ending on the date of the sale or exchange, has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more, this section shall apply with respect to so much of the gain from the sale or exchange of such property as is determined, under regulations prescribed by the Secretary or his delegate, to be attributable to the portion of the property so owned and used by the taxpayer.

**"(6) DETERMINATION OF MARITAL STATUS.—**In the case of any sale or exchange, for purposes of this section—

"(A) the determination of whether an individual is married shall be made as of the date of the sale or exchange; and

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

**"(7) APPLICATION OF SECTIONS 1033 AND 1034.—**In applying sections 1033 (relating to involuntary conversions) and 1034 (relating to sale or exchange of residence), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to an election under this section."

**(b) TECHNICAL AND CLERICAL AMENDMENTS.—**

(1) Section 6012(c) (relating to persons required to make returns of income) is amended to read as follows:

**"(c) CERTAIN INCOME EARNED ABROAD OR FROM SALE OF RESIDENCE.—**For purposes of this section, gross income shall be computed without regard to the exclusion provided for in section 121 (relating to sale of residence by individual who has attained age 65) and without regard to the exclusion provided for in section 911 (relating to earned income from sources without the United States)."

(2) The table of sections for part III of subchapter B of chapter 1 is



is amended by striking out

"Sec. 121. Cross references to other Acts."

and inserting in lieu thereof

"Sec. 121. Gain from sale or exchange of residence of individual who has attained age 65.

"Sec. 122. Cross references to other Acts."

(3) Section 1033(h) (relating to involuntary conversions) is amended by adding at the end thereof the following new paragraph:

"(3) For exclusion from gross income of certain gain from involuntary conversion of residence of taxpayer who has attained age 65, see section 121."

(4) Section 1034 (relating to sale or exchange of residence) is amended by adding at the end thereof the following new subsection:

"(k) CROSS REFERENCE.—

"For exclusion from gross income of certain gain from sale or exchange of residence of taxpayer who has attained age 65, see section 121."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 1963, in taxable years ending after such date.

SEC. 207. DENIAL OF DEDUCTION FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES.

(a) IN GENERAL.—Subsections (a), (b), and (c) of section 161 (relating to deduction for taxes) are amended to read as follows:

"(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

"(1) State and local, and foreign, real property taxes.

"(2) State and local personal property taxes.

"(3) State and local, and foreign, income, war profits, and excess profits taxes.

"(4) State and local general sales taxes.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

"(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PERSONAL PROPERTY TAXES.—The term 'personal property tax' means an ad valorem tax which is imposed on an annual basis in respect of personal property.

"(2) GENERAL SALES TAXES.—

"(A) IN GENERAL.—The term 'general sales tax' means a tax imposed at one rate in respect of the sale at retail of a broad range of classes of items.

"(B) SPECIAL RULES FOR FOOD, ETC.—In the case of items of food, clothing, medical supplies, and motor vehicles—

"(i) the fact that the tax does not apply in respect of some or all of such items shall not be taken into account in determining whether the tax applies in respect of a broad range of classes of items, and

"(ii) the fact that the rate of tax applicable in respect of some or all of such items is lower than the general rate of tax shall not be taken into account in determining whether the tax is imposed at one rate.

"(C) ITEMS TAXED AT DIFFERENT RATES.—Except in the case of a lower rate of tax applicable in respect of an item described in subparagraph (B) no deduction shall be allowed under this section for any general sales tax imposed in respect of an item at a rate other than the general rate of tax.

"(D) COMPENSATING USE TAXES.—A compensating use tax in respect of an item shall be treated as a general sales tax. For purposes of the preceding sentence, the term 'compensating use tax' means, in respect of any item, a tax which—

"(1) is imposed on the use, storage, or consumption of such item, and

"(ii) is complementary to a general sales tax, but only if a deduction is allowable under subsection (a) (4) in respect of items sold at retail in the taxing jurisdiction which a similar to such item.

"(B) SEPARATELY STATED GENERAL SALES TAXES.—If the amount of any general sales tax is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be treated as a tax imposed on, and paid by, such consumer.

"(3) STATE OR LOCAL TAXES.—A State or local tax includes only a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia.

"(4) FOREIGN TAXES.—A foreign tax includes only a tax imposed by the authority of a foreign country.

"(c) DEDUCTION DENIED IN CASE OF CERTAIN TAXES.—No deduction shall be allowed for the following taxes:

"(1) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance of interest charges.

"(2) Taxes on real property, to the extent that subsection (d) requires such taxes to be treated as imposed on another taxpayer."

(b) TECHNICAL AMENDMENTS.—

(1) The first sentence of section 164(f) (relating to payments for municipal services in atomic energy communities) is amended by inserting "State" before "real property taxes".

(2) Section 164(g) (relating to cross references) is amended to read as follows:

"(g) CROSS REFERENCES.—

"(1) For provisions disallowing any deduction for the payment of the tax imposed by subchapter B of chapter 3 (relating to tax-free covenant bonds), see section 1451.

"(2) For provisions disallowing any deduction for certain taxes, see section 275."

(3) (A) Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by adding at the end thereof the following new section:

**"SEC. 275. CERTAIN TAXES.**

"(a) GENERAL RULE.—No deduction shall be allowed for the following taxes:

"(1) Federal income taxes, including—

"(A) the tax imposed by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act);

"(B) the taxes imposed by sections 3201 and 3211 (relating to the taxes on railroad employees and railroad employee representatives); and

"(C) the tax withheld at source on wages under section 3102, and corresponding provisions of prior revenue laws.

"(2) Federal war profits and excess profits taxes.

"(3) Estate, inheritance, legacy, succession, and gift taxes.

"(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 901 (relating to the foreign tax credit).

"(5) Taxes on real property, to the extent that section 164(d) requires such taxes to be treated as imposed on another taxpayer.

"(b) CROSS REFERENCE.—

"For disallowance of certain other taxes, see section 164(c)."

(B) The table of sections for such part IX is amended by adding at the end thereof the following:

"Sec. 275. Certain taxes."

(4) Paragraph (1) of section 535(b) (relating to adjustments to accumulated taxable income) is amended by striking out "section 164(b) (6)" and inserting in lieu thereof "section 275(a) (4)".

(5) The first sentence of paragraph (1) of section 545(b) (relating to adjustments to personal holding company taxable income) is amended by striking out "section 164(b) (6)" and inserting in lieu thereof "section 275(a) (4)".

(6) The first sentence of paragraph (1) of section 556(b) (relating to adjustments to foreign personal holding company taxable income) is amended by striking out "section 164(b) (6)" and inserting in lieu thereof "section 275(a) (4)".

(7) Paragraph (1) of section 901(d) (relating to credit for taxes imposed by foreign countries) is amended by striking out "section 164" and inserting in lieu thereof "sections 164 and 275".

(8) Section 903 (relating to credit for taxes imposed by a foreign country in lieu of income, etc., taxes) is amended by striking out "section 164(b)" and inserting in lieu thereof "sections 164(a) and 275(a)".

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1963.

#### SEC. 208. PERSONAL CASUALTY AND THEFT LOSSES.

(a) **LIMITATION ON AMOUNT OF CASUALTY OR THEFT LOSS DEDUCTION.**—Section 165(c) (3) (relating to losses of property not connected with trade or business) is amended to read as follows:

"(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds \$100. For purposes of the \$100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return."

(b) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall apply to losses sustained after December 31, 1963, in taxable years ending after such date.

#### SEC. 209. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) **CERTAIN ORGANIZATIONS ADDED TO ADDITIONAL 10-PERCENT CHARITABLE LIMITATION.**—Section 170(b) (1) (A) (relating to limitation on amount of deduction for charitable contributions by individuals) is amended by striking out "or" at the end of clause (iii), and by inserting after clause (iv) the following new clauses:

"(v) a governmental unit referred to in subsection (c) (1), or  
 "(vi) an organization referred to in subsection (c) (2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c) (1) or from direct or indirect contributions from the general public,"

(b) **5-YEAR CARRYOVER OF CERTAIN CHARITABLE CONTRIBUTIONS MADE BY CORPORATIONS.**—

(1) **IN GENERAL.**—Section 170(b) (2) (relating to limitation on amount of deduction for charitable contributions by corporations) is amended by striking out the sentence following subparagraph (D) and inserting in lieu thereof the following:

"Any contribution made by a corporation in a taxable year (hereinafter in this sentence referred to as the 'contribution year') in excess of the amount deductible for such year under the preceding sentence shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under the preceding sentence over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this sentence for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable years, the portion of such excess contribution not deductible under this sentence for any taxable year intervening between the contribution year and such succeeding taxable year."

(2) CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.—Paragraph (19) of section 381(c) (relating to items of distributor or transferor corporation) is amended to read as follows:

"(19) CHARITABLE CONTRIBUTIONS IN EXCESS OF PRIOR YEARS' LIMITATIONS.—Contributions made in the taxable year ending on the date of distribution or transfer and the 4 prior taxable years by the distributor or transferor corporation in excess of the amount deductible under section 170(b)(2) for such taxable years shall be deductible by the acquiring corporation for its taxable years which begin after the date of distribution or transfer, subject to the limitations imposed in section 170(b)(2). In applying the preceding sentence, each taxable year of the distributor or transferor corporation beginning on or before the date of distribution or transfer shall be treated as a prior taxable year with reference to the acquiring corporation's taxable years beginning after such date."

(c) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (f) and (g) as subsections (g) and (h), respectively, and by inserting after subsection (e) the following new subsection:

"(f) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—For purposes of this section, payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in section 267(b). For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property. This subsection shall not apply to any charitable contribution where—

"(1) the sole intervening interest or right is a nontransferable life interest reserved by the donor, or

"(2) in the case of a joint gift by husband and wife, the sole intervening interest or right is a nontransferable life interest reserved by the donors which expires not later than the death of whichever of such donors dies later. For purposes of the preceding sentence, a fixture which is intended to be severed the reserved life interest to the donee of the future interest shall not be treated as making a life interest transferable."

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall apply with respect to contributions which are paid (or treated as paid under section 170(a)(2) of the Internal Revenue Code of 1954) in taxable years beginning after December 31, 1963. The amendments made by subsection (c) shall apply to transfers of future interests made after December 31, 1963, in taxable years ending after such date.

#### SEC. 210. ONE-PERCENT LIMITATION ON MEDICINE AND DRUGS.

(a) GENERAL RULE.—Subsection (b) of section 213 (relating to medical, dental, etc., expenses) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to amounts paid for the care of—

"(1) the taxpayer and his spouse, if either of them has attained the age of 65 before the close of taxable year, or

"(2) any dependent described in subsection (a)(1)(A)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

#### SEC. 211. CARE OF DEPENDENTS.

(a) CHILD CARE ALLOWANCE.—Section 214 (relating to expenses for care of certain dependents) is amended to read as follows:

##### "SEC. 214. EXPENSES FOR CARE OF CERTAIN DEPENDENTS.

"(a) GENERAL RULE.—There shall be allowed as a deduction expenses paid during the taxable year by a taxpayer who is a woman or widower, or is a husband whose wife is incapacitated or is institutionalized, for the care of one or more dependents (as defined in subsection (d)(1)), but only if such care is for the purpose of enabling the taxpayer to be gainfully employed.

"(b) LIMITATIONS.—

"(1) DOLLAR LIMIT.—

"(A) Except as provided in subparagraph (B), the deduction under subsection (a) shall not exceed \$600 for any taxable year.

"(B) The \$600 limit of subparagraph (A) shall be increased (to an amount not above \$900) by the amount of expenses incurred by the taxpayer for any period during which—

"(i) the taxpayer had 2 or more dependents, and

"(ii) paragraph (2) does not apply.

"(2) WORKING WIVES.—In the case of a woman who is married, the deduction under subsection (a)—

"(A) shall not be allowed unless she files a joint return with her husband for the taxable year, and

"(B) shall be reduced by the amount (if any) by which the adjusted gross income of the taxpayer and her spouse exceeds \$4,500.

This paragraph shall not apply to expenses incurred while the taxpayer's husband is incapable of self-support because mentally or physically defective.

"(3) HUSBANDS WITH INCAPACITATED WIVES.—In the case of a husband whose wife is incapacitated, the deduction under subsection (a)—

"(A) shall not be allowed unless he files a joint return with his wife for the taxable year, and

"(B) shall be reduced by the amount (if any) by which the adjusted gross income of the taxpayer and his spouse exceeds \$4,500.

This paragraph shall not apply to expenses incurred while the taxpayer's wife is institutionalized if such institutionalization is for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

"(4) CERTAIN PAYMENTS NOT TAKEN INTO ACCOUNT.—Subsection (a) shall not apply to any amount paid to an individual with respect to whom the taxpayer is allowed for his taxable year a deduction under section 151 (relating to deductions for personal exemptions).

"(c) SPECIAL RULE WHERE WIFE IS INCAPACITATED OR INSTITUTIONALIZED.—In the case of a husband whose wife is incapacitated or is institutionalized, the deduction under subsection (a) shall be allowed only for expenses incurred while the wife was incapacitated or institutionalized (as the case may be) for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

"(d) DEFINITIONS.—For purposes of this section—

"(1) DEPENDENT.—The term 'dependent' means a person with respect to whom the taxpayer is entitled to an exemption under section 151(e)(1)—

"(A) who has not attained the age of 13 years and who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer; or

"(B) who is physically or mentally incapable of caring for himself.

"(2) WIDOWER.—The term 'widower' includes an unmarried individual who is legally separated from his spouse under a decree of divorce or of separate maintenance.

"INCAPACITATED WIFE.—A wife shall be considered incapacitated only (A) while she is incapable of caring for herself because mentally or physically defective, or (B) while she is institutionalized.

"(4) INSTITUTIONALIZED WIFE.—A wife shall be considered institutionalized only while she is, for the purpose of receiving medical care or treatment, an inpatient, resident, or inmate of a public or private hospital, sanitarium, or other similar institution.

"(5) DETERMINATION OF STATUS.—A woman shall not be considered as married if—

"(A) she is legally separated from her spouse under a decree of divorce or of separate maintenance at the close of the taxable year, or

"(B) she has been deserted by her spouse, does not know his whereabouts (and has not known his whereabouts at any time during the taxable year), and has applied to a court of competent jurisdiction for appropriate process to compel him to pay support or otherwise to comply with the law or a judicial order, as determined under regulations prescribed by the Secretary or his delegate."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

**SEC. 212. MOVING EXPENSES.****(a) DEDUCTION ALLOWED FOR MOVING EXPENSES.—**

(1) Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 217 as section 219 and by inserting after section 216 the following new section:

**"SEC. 217. MOVING EXPENSES.**

"(a) **DEDUCTION ALLOWED.**—There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee at a new principal place of work.

**"(b) DEFINITION OF MOVING EXPENSES.—**

"(1) **IN GENERAL.**—For purposes of this section, the term 'moving expenses' means only the reasonable expenses—

"(A) of moving household goods and personal effects from the former residence to the new residence, and

"(B) of traveling (including meals and lodging) from the former residence to the new place of residence.

"(2) **INDIVIDUALS OTHER THAN TAXPAYER.**—In the case of any individual other than the taxpayer, expenses referred to in paragraph (1) shall be taken into account only if such individual has both the former residence and the new residence as his principal place of abode and is a member of the taxpayer's household.

"(c) **CONDITIONS FOR ALLOWANCE.**—No deduction shall be allowed under this section unless—

"(1) the taxpayer's new principal place of work—

"(A) is at least 20 miles farther from his former residence than was his former principal place of work, or

"(B) if he had no former principal place of work, is at least 20 miles from his former residence, and

"(2) during the 12-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee, in such general location, during at least 39 weeks.

**"(d) RULES FOR APPLICATION OF SUBSECTION (c) (2).—**

"(1) Subsection (c) (2) shall not apply to any item to the extent that the taxpayer receives reimbursement or other expense allowance from his employer for such item.

"(2) If a taxpayer has not satisfied the condition of subsection (c) (2) before the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which he paid or incurred moving expenses which would otherwise be deductible under this section, but may still satisfy such condition, then such expenses may (at the election of the taxpayer) be deducted for such taxable year notwithstanding subsection (c) (2).

**"(3) If—**

"(A) for any taxable year moving expenses have been deducted in accordance with the rule provided in paragraph (2), and

"(B) the condition of subsection (c) (2) is not satisfied by the close of the subsequent taxable year.

then an amount equal to the expenses which were so deducted shall be included in gross income for such subsequent taxable year.

"(e) **DISALLOWANCE OF DEDUCTION WITH RESPECT TO REIMBURSEMENTS NOT INCLUDED IN GROSS INCOME.**—No deduction shall be allowed under this section for any item to the extent that the taxpayer receives reimbursement or other expense allowance for such item which is not included in his gross income.

"(f) **REGULATIONS.**—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section."

(2) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out—

"Sec. 217. Cross references."

and inserting in lieu thereof the following:

"Sec. 217. Moving expenses.

"Sec. 218. Certain contributions by employees for group-term life insurance.

"Sec. 219. Cross references."

(b) **ADJUSTED GROSS INCOME.**—Section 62 (defining adjusted gross income) is amended by inserting after paragraph (7) the following new paragraph:

“(8) **MOVING EXPENSE DEDUCTION.**—The deduction allowed by section 217.”

(c) **WITHHOLDING.**—Section 3401(a) (relating to definition of “wages”) is amended by adding after paragraph (14) (added by section 203(c) of this Act) the following new paragraph:

“(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217.”

(d) **EFFECTIVE DATES.**—The amendments made by subsections (a) and (b) shall apply to expenses incurred after December 31, 1963, in taxable years ending after such date. The amendment made by subsection (c) shall apply with respect to remuneration paid after December 31, 1963.

**SEC. 213. INTEREST ON LOANS INCURRED TO PURCHASE CERTAIN INSURANCE AND ANNUITY CONTRACTS.**

(a) **DISALLOWANCE OF INTEREST DEDUCTION.**—Section 264(a) (relating to certain amounts paid in connection with insurance contracts) is amended—

(1) by inserting after paragraph (2) the following new paragraph:

“(3) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise).”

(2) by adding at the end thereof the following new sentence: “Paragraph (3) shall apply only in respect of contracts purchased after August 6, 1963.”

(b) **EXCEPTIONS.**—Section 264 is amended by adding at the end thereof the following new subsection:

“(c) **EXCEPTIONS.**—Subsection (a) (3) shall not apply to any amount paid or accrued by a person during a taxable year on indebtedness incurred or continued as part of a plan referred to in subsection (a) (3)—

“(1) if no part of 4 of the annual premiums due during the 7-year period (beginning with the date the first premium on the contract to which such plan relates was paid) is paid under such plan by means of indebtedness,

“(2) if the total of the amounts paid or accrued by such person during such taxable year for which (without regard to this paragraph) no deduction would be allowable by reason of subsection (a) (3) does not exceed \$100,

“(3) if such amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in his financial obligations, or

“(4) if such indebtedness was incurred in connection with his trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new 7-year period described in such paragraph with respect to such contract shall commence on the date the first such increased premium is paid.”

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply with respect to amounts paid or accrued in taxable years beginning after December 31, 1963.

**SEC. 214. EMPLOYEE STOCK OPTIONS AND PURCHASE PLANS.**

(a) **IN GENERAL.**—Part II of subchapter D of chapter 1 is amended to read as follows:

**“PART II—CERTAIN STOCK OPTIONS**

“Sec. 421. General rules.

“Sec. 422. Qualified stock options.

“Sec. 423. Employee stock purchase plans.

“Sec. 424. Restricted stock options.

“Sec. 425. Definitions and special rules.

**“SEC. 421. GENERAL RULES.**

“(a) **EFFECT OF QUALIFYING TRANSFER.**—If a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a), 423(a), or 424(a) are met—

"(1) except as provided in section 422(c)(1), no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

"(2) no deduction under section 162 (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a parent or subsidiary corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, with respect to the share so transferred; and

"(3) no amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

"(b) EFFECT OF DISQUALIFYING DISPOSITION.—If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 422(a), 423(a), or 424(a) except that there is a failure to meet any of the holding period requirements of section 422(a)(1), 423(a)(1), or 424(a)(1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

"(c) EXERCISE BY ESTATE.—

"(1) IN GENERAL.—If an option to which this part applies is exercised after the death of the employee by the estate of the decedent, or by a person who acquired the right to exercise such option by bequest or inheritance or by reason of the death of the decedent, the provisions of subsection (a) shall apply to the same extent as if the option had been exercised by the decedent, except that—

"(A) the holding period and employment requirements of sections 422(a), 423(a), and 424(a) shall not apply, and

"(B) any transfer by the estate of stock acquired shall be considered a disposition of such stock for purposes of sections 423(c) and 424(c)(1).

"(2) DEDUCTION FOR ESTATE TAX.—If an amount is required to be included under section 422(c)(1), 423(c), or 424(c)(1) in gross income of the estate of the deceased employee or of a person described in paragraph (1), there shall be allowed to the estate or such person a deduction with respect to the estate tax attributable to the inclusion in the taxable estate of the deceased employee of the net value for estate tax purposes of the option. For this purpose, the deduction shall be determined under section 691(c) as if the option acquired from the deceased employee were an item of gross income in respect of the decedent under section 691 and as if the amount includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) were an amount included in gross income under section 691 in respect of such item of gross income.

"(3) BASIS OF SHARES ACQUIRED.—In the case of a share of stock acquired by the exercise of an option to which paragraph (1) applies—

"(A) the basis of such share shall include so much of the basis of the option as is attributable to such share; except that the basis of such share shall be reduced by the excess (if any) of (i) the amount, which would have been includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) if the employee had exercised the option on the date of his death and had held the share acquired pursuant to such exercise at the time of his death, over (ii) the amount which is includible in gross income under such section; and

"(B) the last sentence of sections 422(c)(1), 423(c), and 424(c)(1) shall apply only to the extent that the amount includible in gross income under such sections exceeds so much of the basis of the option as is attributable to such share.

#### "SEC. 422. QUALIFIED STOCK OPTIONS.

"(a) IN GENERAL.—Subject to the provisions of subsection (c)(1), section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if—

"(1) no disposition of such share is made by such individual within the 3-year period beginning on the day after the day of the transfer of such share, and

"(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was an employee of either the corporation granting



such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425 (a) applies.

"(b) **QUALIFIED STOCK OPTION.**—For purposes of this part, the term "qualified stock option" means an option granted to an individual after June 11, 1963 (other than a restricted stock option granted pursuant to a contract described in section 424(c) (4) (A)), for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

"(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options, and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

"(2) such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders, whichever is earlier;

"(3) such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted;

"(4) except as provided in subsection (c) (1), the option price is not less than the fair market value of the stock at the time such option is granted;

"(5) such option by its terms is not exercisable while there is outstanding (within the meaning of subsection (c) (2)) any qualified stock option (or restricted stock option) which was granted, before the granting of such option, to such individual to purchase stock in his employer corporation or in a corporation which (at the time of the granting of such option) is a parent or subsidiary corporation of the employer corporation, or in a predecessor corporation of any of such corporations;

"(6) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

"(7) such individual, immediately after such option is granted, does not own stock possessing more than 5 percent of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation; except that if the equity capital of such corporation or corporations (determined at the time the option is granted) is less than \$2,000,000, then, for purposes of applying the limitation of this paragraph, there shall be added to such 5 percent the percentage (not higher than 5 percent) which bears the same ratio to 5 percent as the difference between such equity capital and \$2,000,000 bears to \$1,000,000.

"(c) **SPECIAL RULES.**—

"(1) **EXERCISE OF OPTION WHEN PRICE IS LESS THAN VALUE OF STOCK.**—If a share of stock is transferred pursuant to the exercise by an individual of an option which fails to qualify as a qualified stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b) (4), the requirement of subsection (b) (4) shall be considered to have been met, but there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income for the taxable year in which such option is exercised, an amount equal to the lesser of—

"(A) 150 percent of the difference between the option price and the fair market value of the share at the time the option was granted, or

"(B) the difference between the option price and the fair market value of the share at the time of such exercise.

The basis of the share acquired shall be increased by an amount equal to the amount included in his gross income under this paragraph in the taxable year in which the exercise occurred.

"(2) **CERTAIN OPTIONS TREATED AS OUTSTANDING.**—For purposes of subsection (b) (5)—

"(A) any restricted stock option which is not terminated before January 1, 1965, and

"(B) any qualified stock option granted after June 11, 1963, shall be treated as outstanding until such option is exercised in full or expires by reason of the lapse of time. For purposes of the preceding sentence, a restricted stock option granted before June 12, 1963, shall not be treated

as outstanding for any period before the first day on which (under the terms of such option) it may be exercised.

"(3) **OPTIONS GRANTED TO CERTAIN SHAREHOLDERS.**—For purposes of subsection (b) (7)—

"(A) the term 'equity capital' means—

"(i) in the case of one corporation, the sum of its money and other property (in an amount equal to the adjusted basis of such property for determining gain), less the amount of its indebtedness (other than indebtedness to shareholders), and

"(ii) in the case of a group of corporations consisting of a parent and its subsidiary corporations, the sum of the equity capital of each such corporations adjusted, under regulations prescribed by the Secretary or his delegate, to eliminate the effect of intercorporate ownership or transactions among such corporations;

"(B) the rules of section 425(d) shall apply in determining the stock ownership of the individual; and

"(C) stock which the individual may purchase under outstanding options shall be treated as stock owned by such individual.

If an individual is granted an option which permits him to purchase stock in excess of the limitation of subsection (b) (7) (determined by applying the rules of this paragraph), such option shall be treated as meeting the requirement of subsection (b) (7) to the extent that such individual could, if the option were fully exercised at the time of grant, purchase stock under such option without exceeding such limitation. The portion of such option which is treated as meeting the requirement of subsection (b) (7) shall be deemed to be that portion of the option which is first exercised.

"(4) **CERTAIN DISQUALIFYING DISPOSITIONS WHERE AMOUNT REALIZED IS LESS THAN VALUE AT EXERCISE.**—If—

"(A) an individual who has acquired a share of stock by the exercise of a qualified stock option makes a disposition of such share within the 3-year period described in subsection (a) (1), and

"(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual, then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the amount paid for such share.

"(5) **CERTAIN TRANSFERS BY INSOLVENT INDIVIDUALS.**—If an insolvent individual holds a share of stock acquired pursuant to his exercise of a qualified stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary, in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in such proceeding, shall constitute a 'disposition of such share' for purposes of subsection (a) (1).

"**SEC. 423. EMPLOYEE STOCK PURCHASE PLANS.**

"(a) **GENERAL RULE.**—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted after June 11, 1963 (other than a restricted stock option granted pursuant to a plan described in section 424(c) (4) (B)), under an employee stock purchase plan (as defined in subsection (b)) if—

"(1) no disposition of such share is made by him within 2 years after the date of the granting of the option nor within 6 months after the transfer of such share to him; and

"(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of the corporation granting such option, a parent or subsidiary corporation of such corporation or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies.

"(b) **EMPLOYEE STOCK PURCHASE PLAN.**—For purposes of this part, the term 'employee stock purchase plan' means a plan which meets the following requirements:

"(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporations;

"(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

"(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 425(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

"(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

"(A) employees who have been employed less than 2 years,

"(B) employees whose customary employment is 20 hours or less per week,

"(C) employees whose customary employment is for not more than 5 months in any calendar year, and

"(D) officers, persons whose principal duties consist of supervising the work of other employees or highly compensated employees;

"(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, of employees, and the plan may form relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock fixed under the plan;

"(6) under the terms of the plan, the option price is not less than the lesser of—

"(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

"(B) an amount which under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time such option is exercised;

"(7) under the terms of the plan, such option cannot be exercised after the expiration of—

"(A) 5 years from the date such option is granted if, under the terms of such plan, the option price is to be not less than 85 percent of the fair market value of such stock at the time of the exercise of the option, or

"(B) 27 months from the date such option is granted, if the option price is not determinable in the manner described in subparagraph (A);

"(8) under the terms of the plan, no employee may be granted an option which permits his rights to purchase stock under all such plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds \$25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this paragraph—

"(A) the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

"(B) the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed \$25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

"(B) a written plan adopted and approved before June 12, 1963, which (as of June 12, 1963, and as of the date of the granting of the option)—

"(i) met the requirements of paragraphs (4) and (5) of section 423(b), or

"(ii) was being administered in a way which did not discriminate in favor of officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees.

**"SEC. 425. DEFINITIONS AND SPECIAL RULES.**

"(a) CORPORATE REORGANIZATIONS, LIQUIDATIONS, ETC.—For purposes of this part, the term 'issuing or assuming a stock option in a transaction to which section 425(a) applies' means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation, if—

"(1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

"(2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

For purposes of this subsection, the parent-subsidiary relationship shall be determined at the time of any such transaction under this subsection.

"(b) ACQUISITION OF NEW STOCK.—For purposes of this part, if stock is received by an individual in a distribution to which section 305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, and such distribution was made with respect to stock transferred to him up on his exercise of the option, such stock shall be considered as having been transferred to him on his exercise of such option. A similar rule shall be applied in the case of a series of such distributions.

"(c) DISPOSITION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of this part, the term 'disposition' includes a sale, exchange, gift, or a transfer of legal title, but does not include—

"(A) a transfer from a decedent to an estate or a transfer by bequest or inheritance;

"(B) an exchange to which section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies; or

"(C) a mere pledge or hypothecation.

"(2) JOINT TENANCY.—The acquisition of a share of stock in the name of the employee and another jointly with the right of survivorship or a subsequent transfer of a share of stock into such joint ownership shall not be deemed a disposition, but a termination of such joint tenancy (except to the extent such employee acquires ownership of such stock) shall be treated as a disposition by him occurring at the time such joint tenancy is terminated.

"(d) ATTRIBUTION OF STOCK OWNERSHIP.—For purposes of this part, in applying the percentage limitations of sections 422(b)(7), 423(b)(3), and 424(b)(3)—

"(1) the individual with respect to whom such limitation is being determined shall be considered as owning the stock owned, directly or indirectly, by or for his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendant; and

"(2) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries.

"(e) PARENT CORPORATION.—For purposes of this part, the term 'parent corporation' means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

"(f) **SUBSIDIARY CORPORATION.**—For purposes of this part, the term 'subsidiary corporation' means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

"(g) **SPECIAL RULE FOR APPLYING SUBSECTIONS (e) AND (f).**—In applying subsections (e) and (f) for purposes of section 422(a)(2), 423(a)(2), and 424(a)(2), there shall be substituted for the term 'employer corporation' wherever it appears in subsections (e) and (f) the term 'grantor corporation', or the term 'corporation issuing or assuming a stock option in a transaction to which section 425 (a) applies, as the case may be.

"(h) **MODIFICATION, EXTENSION, OR RENEWAL OF OPTION.**—

"(1) **IN GENERAL.**—For purposes of this part, if the terms of any option to purchase stock are modified, extended, or renewed, such modification, extension, or renewal shall be considered as the granting of a new option.

"(2) **SPECIAL RULES FOR SECTIONS 423 AND 424 OPTIONS.**—

"(A) In the case of the transfer of stock pursuant to the exercise of an option to which section 423 or 424 applies and which has been so modified, extend, or renewed, then, except as provided in subparagraph (B), the fair market value of such stock at the time of the granting of such option shall be considered as whichever of the following is the highest:

"(i) the fair market value of such stock on the date of the original granting of the option,

"(ii) the fair market value of such stock on the date of the making of such modification, extension, or renewal, or

"(iii) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal.

"(B) Subparagraph (A) shall not apply with respect to a modification, extension, or renewal of a restricted stock option before June 12, 1963 (or after June 11, 1963, if made pursuant to a binding written contract entered into before June 12, 1963), if the aggregate of the monthly average fair market values of the stock subject to the option for the 12 consecutive calendar months before the date of the modification, extension, or renewal, divided by 12, is an amount less than 80 percent of the fair market value of such stock on the date of the original granting of the option or the date of the making of any intervening modification, extension, or renewal, whichever is the highest.

"(3) **DEFINITION OF MODIFICATION.**—The term 'modification' means any change in the terms of the option which gives the employee additional benefits under the option, but such term shall not include a change in the terms of the option—

(A) attributable to the issuance or assumption of an option under subsection (a); or

"(B) to permit the option to qualify under sections 422(b)(6), 423(b)(9), and 424(b)(2).

If a restricted stock option is exercisable after the expiration of 10 years from the date such option is granted, subparagraph (B) shall not apply unless the terms of the option are also changed to make it not exercisable after the expiration of such period.

"(1) **CROSS REFERENCES.**—

"For provisions requiring the reporting of certain acts with respect to a qualified stock option, options granted under employer stock purchase plans, or a restricted stock option, see section 6039."

(b) **ADMINISTRATIVE PROVISIONS.**—

(1) **REPORTING REQUIREMENT FOR CERTAIN OPTIONS.**—Subpart A of part III of subchapter A of chapter 61 (relating to information returns) is amended by renumbering section 6039 as 6040, and by inserting after section 6038 the following new section:

"**SEC. 6039. INFORMATION REQUIRED IN CONNECTION WITH CERTAIN OPTIONS.**

"(a) **REQUIREMENT OF REPORTING.**—Every corporation—

"(1) which in any calendar year transfers a share of stock to any person pursuant to such person's exercise of a qualified stock option or a restricted stock option, or

“(C) a right to purchase stock which has accrued under one option granted pursuant to the plan may not be carried over to any other option; and

“(9) under the terms of the plan, such option is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

For purposes of paragraphs (3) to (9), inclusive, where additional terms are contained in an offering made under a plan, such additional terms shall, with respect to options exercised under such offering, be treated as a part of the terms of such plan.

“(c) SPECIAL RULE WHERE OPTION PRICE IS BETWEEN 85 PERCENT AND 100 PERCENT OF VALUE OF STOCK.—If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirement of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation, and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

“(1) the excess of the fair market value of the share at the time of such disposition or death over the amount paid for the share under the option, or

“(2) the excess of the fair market value of the share at the time the option was granted over the option price.

If the option price is not fixed or determinable at the time the option is granted, then for purposes of this subsection, the option price shall be determined as if the option were exercised at such time. In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

#### “SEC. 424. RESTRICTED STOCK OPTIONS.

“(a) IN GENERAL.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise after 1949 of a restricted stock option, if—

“(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, and

“(2) at the time he exercises such option—

“(A) he is an employee of either the corporation granting such option a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, or

“(B) he ceased to be an employee of such corporations within the 3-month period preceding the time of exercise.

“(b) RESTRICTED STOCK OPTION.—For purposes of this part, the term ‘restricted stock option’ means an option granted after February 26, 1945, and before June 12, 1963 (or, if it meets the requirements of subsection (c)(4), an option granted after June 11, 1963), to an individual, for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

“(1) at the time such option is granted—

“(A) the option price is at least 85 percent of the fair market value at such time of the stock subject to the option, or

“(B) in the case of a variable price option, the option price (computed as if the option had been exercised when granted) is at least 85 percent of the fair market value of the stock at the time such option is granted;

“(2) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him;

“(3) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of

all classes of stock of the employer corporation or of its parent or subsidiary corporation. This paragraph shall not apply if at the time such option is granted, the option price is at least 110 percent of the fair market value of the stock subject to the option, and such option either by its terms is not exercisable after the expiration of 5 years from the date such option is granted or is exercised within one year after August 16, 1954. For purposes of this paragraph, the provisions of section 425(d) shall apply in determining the stock ownership of an individual; and

“(4) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted, if such option has been granted on or after June 22, 1954.

“(c) SPECIAL RULES.—

“(1) OPTIONS UNDER WHICH OPTION PRICE IS BETWEEN 85 PERCENT AND 95 PERCENT OF VALUE OF STOCK.—If no disposition of a share of stock acquired by an individual on his exercise after 1949 of a restricted stock option is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, but, at the time the restricted stock option was granted, the option price (computed under subsection (b) (1)) was less than 95 percent of the fair market value at such time of such share, then, in the event of any disposition of such share by him, or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or of the taxable year closing with his death, whichever applies—

“(A) in the case of a share of stock acquired under an option qualifying under subsection (b) (1) (A), an amount equal to the amount (if any) by which the option price is exceeded by the lesser of—

“(i) the fair market value of the share at the time of such disposition or death, or

“(ii) the fair market value of the share at the time the option was granted; or

“(B) in the case of stock acquired under an option qualifying under subsection (b) (1) (B), an amount equal to the lesser of—

“(i) the excess of the fair market value of the share at the time of such disposition or death over the price paid under the option, or

“(ii) the excess of the fair market value of the share at the time the option was granted over the option price (computed as if the option had been exercised at such time).

In the case of a disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

“(2) STOCKHOLDER APPROVAL.—For purposes of this section, if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.

“(3) VARIABLE PRICE OPTION.—For purposes of subsection (b) (1), the term ‘variable price option’ means an option under which the purchase price of the stock is fixed or determinable under a formula in which the only variable is the fair market value of the stock at any time during a period of 6 months which includes the time the option is exercised; except that in the case of options granted after September 30, 1958, such term does not include any such option in which such formula provides for determining such price by reference to the fair market value of the stock at any time before the option is exercised if such value may be greater than the average fair market value of the stock during the calendar month in which the option is exercised.

“(4) CERTAIN OPTIONS GRANTED AFTER JUNE 11, 1963.—For purposes of subsection (b), an option granted after June 11, 1963, meets the requirements of this paragraph if granted pursuant to—

“(A) a binding written contract entered into before June 12, 1963,

or

"(2) which in any calendar year records (or has by its agent recorded) a transfer of the legal title of a share of stock—

"(A) acquired by the transferor pursuant to his exercise of an option described in section 423(c) (relating to special rule where option price is between 85 percent and 100 percent of value of stock), or

"(B) acquired by the transferor pursuant to his exercise of a restricted stock option described in section 424(c) (1) (relating to options under which option price is between 85 percent and 95 percent of value of stock),

shall, for such calendar year, make a return at such time and in such manner, and setting forth such information, as the Secretary or his delegate may by regulations prescribe. For purposes of the preceding sentence, any option which a corporation treats as a qualified stock option, a restricted stock option, or an option granted under an employee stock purchase plan, shall be deemed to be such an option. A return is required by reason of a transfer described in paragraph (2) of a share only with respect to the first transfer of such share by the person who exercised the option.

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every corporation making a return under subsection (a) shall furnish to each person whose name is set forth in such return a written statement setting forth such information as the Secretary or his delegate may by regulations prescribe. The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

"(c) IDENTIFICATION OF STOCK.—Any corporation which transfers any share of stock pursuant to the exercise of an option described in subsection (a) (2) shall identify such stock in a manner adequate to carry out the purposes of this section.

"(d) CROSS REFERENCES.—

"For definition of—

"(1) The term 'qualified stock option', see section 422(b).

"(2) The term 'employee stock purchase plan', see section 423(b).

"(3) The term 'restricted stock option', see section 424(b)."

(2) PENALTIES FOR FAILURE TO FILE INFORMATION RETURNS.—Section 6652(a) (relating to failure to file certain information returns) is amended to read as follows:

"(a) RETURNS RELATING TO PAYMENTS OF DIVIDENDS, ETC., AND CERTAIN TRANSFERS OF STOCK.—In the case of each failure to file a statement of—

"(1) the aggregate amount of payments to another person required by section 6042(a) (1) (relating to payments of dividends aggregating \$10 or more), section 6044(a) (1) (relating to payments of patronage dividends aggregating \$10 or more, or section 6049(a) (1) (relating to payments of interest aggregating \$10 or more), or

"(2) the transfer of stock or the transfer of legal title of stock required by section 6039 (relating to information in connection with certain options), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid (upon notice and demand by the Secretary or his delegate and in the same manner as tax), by the person failing to so file the statement, \$10 for each such statement not so filed, but the total amount imposed on the delinquent person for all such failures during any calendar year shall not exceed \$25,000."

(3) PENALTIES FOR FAILURE TO FURNISH STATEMENTS TO PERSONS WITH RESPECT TO WHOM RETURNS ARE FILED.—Section 6078 (relating to failure to furnish certain statements) is amended—

(A) by striking out "section 6042(c)," and inserting in lieu thereof "section 6039(b), 6042(c)."; and

(B) by striking out "section 6042(a) (1)," and inserting in lieu thereof "section 6039(a), 6042(a) (1)."

(c) TECHNICAL AMENDMENTS.—

(1) Section 402(a) (3) (B) (relating to taxability of beneficiary of employees' trust) is amended by striking out "section 421(d) (2) and (3)" and inserting in lieu thereof "subsections (e) and (f) of section 425".



(2) The last sentence of subparagraph (B) of section 691(c)(2) (relating to allowance of deduction for estate tax in case of items constituting income in respect of a decedent) is amended to read as follows: "Such net value shall be determined with respect to the provisions of section 421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II of subchapter D applies."

(d) CLERICAL AMENDMENTS.—

(1) The table of parts for subchapter D of chapter 1 is amended by striking out

"Part II. Miscellaneous provisions."

and inserting in lieu thereof the following:

"Part II. Certain stock options."

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking out

"Sec. 6039. Cross references."

and inserting in lieu thereof:

"Sec. 6039. Information required in connection with certain options."

"Sec. 6040. Cross references."

(e) EFFECTIVE DATE.—

(1) Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after June 11, 1963.

(2) The amendments made by subsection (b) shall apply to stock transferred pursuant to options exercised on or after January 1, 1964.

**SEC. 215. INTEREST ON CERTAIN DEFERRED PAYMENTS.**

(a) IN GENERAL.—Part III of subchapter E of chapter 1 (relating to accounting periods and methods of accounting) is amended by adding at the end thereof the following new section:

**"SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.**

"(a) AMOUNT CONSTITUTING INTEREST.—For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

"(b) TOTAL UNSTATED INTEREST.—For purposes of this section, the term 'total unstated interest' means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

"(1) the sum of the payments to which this section applies which are due under the contract, over

"(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary or his delegate. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

"(c) PAYMENTS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

"(A) under which some or all of the payments are due more than one year after the date of such sale or exchange, and

"(B) under which, using a rate provided by regulations prescribed by the Secretary or his delegate for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

"(2) TREATMENT OF EVIDENCE OF INDEBTEDNESS.—For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

"(d) PAYMENTS THAT ARE INDEFINITE AS TO TIME, LIABILITY, OR AMOUNT.—In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract; and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

"(e) CHANGE IN TERMS OF CONTRACT.—If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the 'total unstated interest' under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest) payments) under regulations prescribed by the Secretary or his delegate.

"(f) EXCEPTIONS AND LIMITATIONS.—

"(1) SALES PRICE OF \$3,000 OR LESS.—This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed \$3,000.

"(2) CARRYING CHARGES.—In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

"(3) TREATMENT OF SELLER.—In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if no part of any gain on such sale or exchange would be considered as gain from the sale or exchange of a capital asset or property described in section 1231.

"(4) SALES OR EXCHANGES OF PATENTS.—This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents).

"(5) ANNUITIES.—This section shall not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies."

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 483. Interest on certain deferred payments."

(c) CERTAIN CARRYING CHARGES.—The first sentence of section 163(b) (1) (relating to installment purchases where interest charge is not separately stated) is amended by striking out "personal property is purchased" and inserting in lieu thereof "personal property or services are purchased".

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963. The amendment made by subsection (c) shall apply to payments made during taxable years beginning after December 31, 1963.

#### SEC. 216. PERSONAL HOLDING COMPANIES.

(a) PERSONAL HOLDING COMPANY TAX RATE.—Section 541 (relating to imposition of personal holding company tax) is amended by striking out "tax equal to" and all that follows and inserting in lieu thereof: "tax equal to 70 percent of the undistributed personal holding company income."

(b) DEFINITION OF PERSONAL HOLDING COMPANY.—Paragraph (1) of section 542(a) (relating to the gross income requirement for personal holding company purposes) is amended to read as follows:

"(1) ADJUSTED ORDINARY GROSS INCOME REQUIREMENT.—At least 60 percent of its adjusted ordinary gross income (as defined in section 543(b) (2)) for the taxable year is personal holding company income (as defined in section 543(a)), and".

## (c) EXCLUDED CORPORATIONS.—

(1) DOMESTIC BUILDING AND LOAN ASSOCIATIONS.—Paragraph (2) of section 542(c) (relating to corporations excepted from the definition of personal holding company) is amended to read as follows:

"(2) a bank as defined in section 581, or a domestic building and loan association within the meaning of section 7701(a) (19) without regard to subparagraphs (D) and (E) thereof;"

(2) LENDING AND FINANCE COMPANIES.—Section 542(c) is amended by striking out paragraphs (6), (7), (8), and (9), by renumbering paragraphs (10) and (11) as paragraphs (7) and (8), and by inserting after paragraph (5) the following new paragraph:

"(6) a lending or finance company if—

"(A) 60 percent or more of its ordinary gross income (as defined in section 543(b) (1)) is derived directly from the active and regular conduct of a lending or finance business;

"(B) the personal holding company income for the taxable year (computed without regard to income described in subsection (d) (3)) and income derived directly from the active and regular conduct of a lending or finance business, and computed by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for use of corporate property by shareholders), plus the interest described in section 543(b) (2) (C), is not more than 20 percent of the ordinary gross income;

"(C) the sum of the deductions which are directly allocable to the active and regular conduct of its lending or finance business equals or exceeds the sum of—

"(i) 15 percent of so much of the ordinary gross income derived therefrom as does not exceed \$500,000, plus

"(ii) 5 percent of so much of the ordinary gross income derived therefrom as exceeds \$500,000 but not \$1,000,000; and

"(D) the loans to a person who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 544(a) (2), outstanding at any time during such year do not exceed \$5,000 in principal amount;"

(3) SPECIAL RULES FOR SECTION 542(O) (6).—Section 542 is amended by adding at the end thereof the following new subsection:

"(d) SPECIAL RULES FOR APPLYING SUBSECTION (c) (6).—

"(1) LENDING OR FINANCE BUSINESS DEFINED.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), for purposes of subsection (c) (6), the term 'lending or finance business' means a business of—

"(i) making loans, or

"(ii) purchasing or discounting accounts receivable, notes, or installment obligations.

"(B) EXCEPTIONS.—For purposes of subparagraph (A), the term 'lending or finance business' does not include the business of—

"(i) making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, if (at the time of the loan, purchase, or discount) the remaining maturity exceeds 60 months, or

"(ii) making loans evidenced by, or purchasing, certificates of indebtedness issued in a series, under a trust indenture, and in registered form or with interest coupons attached.

For purposes of clause (i), the remaining maturity shall be treated as including any period for which there may be a renewal or extension under the terms of an option exercisable by the borrower.

"(2) BUSINESS DEDUCTIONS.—For purposes of subsection (c) (6) (C), the deductions which may be taken into account shall include only—

"(A) deductions which are allowable only by reason of section 162 or section 404, except there shall not be included any such deduction in respect of compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a) (2)), and

"(B) deductions allowable under section 167, and deductions allowable under section 164 for real property taxes, but in either case only to the extent that the property with respect to which such deductions are allowable is used directly in the active and regular conduct of the lending or finance business.

"(3) INCOME RECEIVED FROM CERTAIN DOMESTIC SUBSIDIARIES.—For purposes subsection (c) (6) (B), in the case of a lending company which is authorized to engage in and is actively and regularly engaged in the small loan business (consumer finance business) under one or more State statutes providing for the direct regulation of such business, and which meets the requirements of subsection (c) (6) (A), there shall not be treated as personal holding company income the lawful income received from domestic subsidiary corporations (of which stock possessing at least 80 percent of the voting power of all classes of stock and of which at least 80 percent of each class of nonvoting stock is owned directly by such lending company) which are themselves excepted under subsection (c) (6)."

(d) PERSONAL HOLDING COMPANY INCOME.—Subsections (a) and (b) of section 543 (relating to personal holding company income) are amended to read as follows:

"(a) GENERAL RULE.—For purposes of this subtitle, the term 'personal holding company income' means the portion of the adjusted ordinary gross income which consists of:

"(1) DIVIDENDS, ETC.—Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to—

"(A) interest constituting rent (as defined in subsection (b) (3)),

"(B) interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936, and

"(C) a dividend distribution of divested stock (as defined in subsection (e) of section 1111), but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

"(2) RENTS.—The adjusted income from rents; except that such adjusted income shall not be included if—

"(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

"(B) the personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (6), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) is not more than 10 percent of the ordinary gross income.

"(3) MINERAL, OIL, AND GAS ROYALTIES.—The adjusted income from mineral, oil, and gas royalties; except that such adjusted income shall not be included if—

"(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income,

"(B) the personal holding company income for the taxable year (computed without regard to this paragraph, and computed by including as personal holding company income copyright royalties and the adjusted income from rents) is not more than 10 percent of the ordinary gross income, and

"(C) the sum of the deductions which are allowable under section 162 (relating to trade or business expenses) other than—

"(i) deductions for compensation for personal services rendered by the shareholders, and

"(ii) deductions which are specifically allowable under sections other than section 162, equals or exceeds 15 percent of the adjusted ordinary gross income.

"(4) COPYRIGHT ROYALTIES.—Copyright royalties; except that copyright royalties shall not be included if—

"(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

“(B) the personal holding company income for the taxable year computed—

“(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

“(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

“(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

“(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

“(i) deductions for compensation for personal services rendered by the shareholders,

“(ii) deductions for royalties paid or accrued, and

“(iii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties.

For purposes of this subsection, the term ‘copyright royalties’ means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5) (B)) received for the use of, or right to use, films. For purposes of this paragraph, the term ‘shareholder’ shall include any person who owns stock within the meaning of section 544.

“(5) PRODUCED FILM RENTS.—

“(A) Produced film rents; except that such rents shall not be included if such rents constitute 50 percent or more of the ordinary gross income.

“(B) For purposes of this section, the term ‘produced film rents’ means payments received with respect to an interest in a film for the use of, or right to use, such film, but only to the extent that such interest was acquired before substantial completion of production of such film.

“(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (2), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) in excess of 10 percent of its ordinary gross income.

“(7) PERSONAL SERVICE CONTRACTS.—

“(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is

to perform the services is designated (by name or by description) in the contract; and

"(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

"(8) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries).

"(b) DEFINITIONS.—For purposes of this part—

"(1) ORDINARY GROSS INCOME.—The term 'ordinary gross income' means the gross income determined by excluding—

"(A) all gains from the sale or other disposition of capital assets, and

"(B) all gains (other than those referred to in subparagraphs (A)) from the sale or other disposition of property described in section 1231(b).

"(2) ADJUSTED ORDINARY GROSS INCOME.—The term 'adjusted ordinary gross income' means the ordinary gross income adjusted as follows:

"(A) RENTS.—From the gross income from rents (as defined in the second sentence of paragraph (3) of this subsection) subtract the amount allowable as deductions for—

"(i) exhaustion, wear and tear, obsolescence, and amortization,

"(ii) property taxes,

"(iii) interest, and

"(iv) rent.

to the extent allowable, under regulations prescribed by the Secretary or his delegate, to such gross income from rents. The amount subtracted under this subparagraph shall not exceed such gross income from rents.

"(B) MINERAL ROYALTIES, ETC.—From the gross income from mineral, oil, and gas royalties described in subsection (a) (3), and from the gross income from working interests in an oil or gas well, subtract the amount allowable as deductions for—

"(i) exhaustion, wear and tear, obsolescence, amortization, and depletion,

"(ii) property and severance taxes,

"(iii) interest, and

"(iv) rent.

to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income from royalties or such gross income from working interests in oil or gas wells. The amount subtracted under this subparagraph with respect to royalties shall not exceed the gross income from such royalties, and the amount subtracted under this subparagraph with respect to working interests shall not exceed the gross income from such working interests.

"(C) INTEREST.—There shall be excluded—

"(i) interest received on a direct obligation of the United States held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in such obligations, and

"(ii) interest on a condemnation award, a judgment, and a tax refund.

"(3) ADJUSTED INCOME FROM RENTS.—The term 'adjusted income from rents' means the gross income from rents, reduced by the amount subtracted under paragraph (2) (A) of this subsection. For purposes of the preceding sentence, the term 'rents' means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under subsection

(a) (6), nor copyright royalties (as defined in subsection (a) (4)), nor produced film rents (as defined in subsection (a) (5) (B)).

"(4) ADJUSTED INCOME FROM MINERAL, OIL, AND GAS ROYALTIES.—The term 'adjusted income from mineral, oil, and gas royalties' means the gross income from such royalties, reduced by the amount subtracted under paragraph (2) (B) of this subsection in respect of such royalties."

(e) FOREIGN PERSONAL HOLDING COMPANY INCOME AND STOCK OWNERSHIP.—Section 553 (relating to foreign personal holding company income) and section 554 (relating to stock ownership) are amended to read as follows:

**"SEC. 553. FOREIGN PERSONAL HOLDING COMPANY INCOME.**

"(a) FOREIGN PERSONAL HOLDING COMPANY INCOME.—For purposes of this subtitle, the term 'foreign personal holding company income' means that portion of the gross income, determined for purposes of section 552, which consists of:

"(1) DIVIDENDS, ETC.—Dividends, interest, royalties, and annuities. This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (e) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 8, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered.

"(2) STOCK AND SECURITIES TRANSACTIONS.—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

"(3) COMMODITIES TRANSACTIONS.—Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This paragraph shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

"(4) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries); and gains from the sale or other disposition of any interest in an estate or trust.

"(5) PERSONAL SERVICE CONTRACTS.—

"(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

"(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

"(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or the right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has foreign personal holding company income for the taxable year, computed without regard to this paragraph and paragraph (7), in excess of 10 percent of its gross income.

"(7) RENTS.—Rents, unless constituting 50 percent or more of the gross income. For purposes of this paragraph, the term 'rents' means compensation, however designated, for the use of, or right to use, property; but does not include amounts constituting foreign personal holding company income under paragraph (6).

"(b) LIMITATION ON GROSS INCOME IN CERTAIN TRANSACTIONS.—For the purposes of this part—

"(1) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a) (2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

"(2) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a) (3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

**"SEC. 554. STOCK OWNERSHIP.**

"(a) CONSTRUCTIVE OWNERSHIP.—For purposes of determining whether a corporation is a foreign personal holding company, insofar as such determination is based on stock ownership under section 552(a) (2), section 553(a) (5), or section 553(a) (6)—

"(1) STOCK NOT OWNED BY INDIVIDUAL.—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

"(2) FAMILY AND PARTNERSHIP OWNERSHIP.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

"(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

"(4) APPLICATION OF FAMILY-PARTNERSHIP AND OPTION RULES.—Paragraphs (2) and (3) shall be applied—

"(A) for purposes of the stock ownership requirement provided in section 552(a) (2), if, but only if, the effect is to make the corporation a foreign personal holding company;

"(B) for purposes of section 553(a) (5) (relating to personal service contracts) or of section 553(a) (6) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

"(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

"(6) OPTION RULE IN LIEU OF FAMILY AND PARTNERSHIP RULE.—If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

"(b) CONVERTIBLE SECURITIES.—Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

"(1) for purposes of the stock ownership requirement provided in section 552(a) (2), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company;

"(2) for purposes of section 553(a) (5) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income; and

"(3) for purposes of section 553(a) (6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities



shall be included unless all outstanding securities having a prior conversion date are also included."

(f) DIVIDENDS-PAID DEDUCTION.—

(1) Paragraph (2) of section 316(b) (relating to special rules for dividend defined) is amended to read as follows:

"(2) DISTRIBUTIONS BY PERSONAL HOLDING COMPANIES.—

"(A) In the case of a corporation which—

"(i) under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or

"(ii) for the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the corresponding provisions of prior law, is a personal holding company under the law applicable to such taxable year,

the term 'dividend' also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year.

"(B) For purposes of subparagraph (A), the term "distribution of property" includes a distribution in complete liquidation occurring within 24 months after the adoption of a plan of liquidation, but—

"(i) only to the extent of the amounts distributed to distributees other than corporate shareholders, and

"(ii) only to the extent that the corporation designates such amounts as a dividend distribution and duly notifies such distributees of such designation, under regulations prescribed by the Secretary or his delegate, but

"(iii) not in excess of the sum of such distributees' allocable share of the undistributed personal holding company income for such year, computed without regard to this subparagraph or section 562(b)."

(2) Section 331(b) (relating to nonapplication of section 301) is amended by inserting after "any distribution of property" the phrase "(other than a distribution referred to in paragraph (2) (B) of section 316(b))".

(3) Section 562(b) (relating to distributions in liquidation) is amended to read as follows:

"(b) DISTRIBUTIONS IN LIQUIDATIONS.—

"(1) Except in the case of a personal holding company described in section 542 or a foreign personal holding company described in section 552—

"(A) in the case of amounts distributed in liquidation, the part of such distribution which is properly chargeable to earnings and profits accumulated after February 28, 1913, shall be treated as a dividend for purposes of computing the dividends paid deduction, and

"(B) in the case of a complete liquidation occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.

"(2) In the case of a complete liquidation of a personal holding company, occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction, to the extent that such amount is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution computed without regard to this paragraph and without regard to subparagraph (B) of section 316(b) (2)."

(4) Section 551(b) (relating to amount included in gross income) is amended by striking out "received as a dividend" and inserting in lieu thereof "received as a dividend (determined as if any distribution in liquidation actually made in such taxable year had not been made)".

(g) ONE-MONTH LIQUIDATIONS.—Section 333 (relating to election as to recognition of gain in certain liquidations) is amended by adding at the end thereof the following new subsection:

“(g) SPECIAL RULE.—

“(1) LIQUIDATIONS BEFORE JANUARY 1, 1966.—In the case of a liquidation occurring before January 1, 1966, of a corporation referred to in paragraph (3)—

“(A) the date ‘December 31, 1953’ referred to in subsections (e) (2) and (f) (1) shall be treated as if such date were ‘December 31, 1962’, and

“(B) in the case of stock in such corporation held for more than 6 months, the term ‘a dividend’ as used in subsection (e) (1) shall be treated as if such term were ‘class B capital gain’.

Subparagraph (B) shall not apply to any earnings and profits to which the corporation succeeds after August 1, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on August 1, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3).

“(2) LIQUIDATIONS AFTER DECEMBER 31, 1965.—

“(A) IN GENERAL.—In the case of a liquidation occurring after December 31, 1965, of a corporation to which this subparagraph applies—

“(i) the date ‘December 31, 1953’ referred to in subsections (e) (2) and (f) (1) shall be treated as if such date were ‘December 31, 1962’, and

“(ii) so much of the gain recognized under subsection (e) (1) as is attributable to the earnings and profits accumulated after February 28, 1913, and before January 1, 1966, shall, in the case of stock in such corporation held for more than 6 months, be treated as class B capital gain, and only the remainder of such gain shall be treated as a dividend.

Clause (ii) shall not apply to any earnings and profits to which the corporation succeeds after August 1, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on August 1, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3).

“(B) CORPORATIONS TO WHICH APPLICABLE.—Subparagraph (A) shall apply only with respect to a corporation which is referred to in paragraph (3) and which—

“(i) on August 1, 1963, owes qualified indebtedness (as defined in section 545(c)),

“(ii) before January 1, 1967, notifies the Secretary or his delegate that it may wish to have subparagraph (a) apply to it and submits such information as may be required by regulations prescribed by the Secretary or his delegate, and

“(iii) liquidates before the close of the taxable year in which such corporation ceases to owe such qualified indebtedness or (if earlier) the taxable year referred to in subparagraph (C).

“(C) ADJUSTED POST-1963 EARNINGS AND PROFITS EXCEED QUALIFIED INDEBTEDNESS.—In the case of any corporation, the taxable year referred to in this subparagraph is the first taxable year at the close of which is adjusted post-1963 earnings and profits equal or exceed the amount of such corporation’s qualified indebtedness on August 1, 1963. For purposes of the preceding sentence, the term ‘adjusted post-1963 earnings and profits’ means the sum of—

“(i) the earnings and profits of such corporation for taxable year beginning after December 31, 1963, without diminution by reason of any distributions made out of such earnings and profits, and

“(ii) the deductions allowed for taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, or amortization.

"(3) CORPORATIONS REFERRED TO.—For purposes of paragraphs (1) and (2), a corporation referred to in this paragraph is a corporation which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year."

(h) EXCEPTION FOR CERTAIN CORPORATIONS.—

(1) GENERAL RULE.—Except as provided in paragraph (2), in the case of a corporation referred to in section 333(g)(3) of the Internal Revenue Code of 1954 (as added by subsection (g) of this section), the amendments made by this section (other than subsections (f) and (g)) shall not apply if there is a complete liquidation of such corporation and if the distribution of all the property under such liquidation occurs before January 1, 1966.

(2) EXCEPTION.—Paragraph (1) shall not apply to any liquidation to which section 332 of the Internal Revenue Code of 1954 applies unless—

(A) the corporate distributee (referred to in subsection (b)(1) of such section 332) in such liquidation is liquidated in a complete liquidation to which such section 332 does not apply, and

(B) the distribution of all the property under such liquidation occurs before the 91st day after the last distribution referred to in paragraph (1) and before January 1, 1966.

(i) DEDUCTION FOR AMORTIZATION OF INDEBTEDNESS.—

(1) Section 545(a) (relating to definition of undistributed personal holding company income) is amended by striking out "subsection (b)" and inserting in lieu thereof "subsections (b) and (c)".

(2) Section 545 is amended by adding at the end thereof the following new subsection:

"(c) SPECIAL ADJUSTMENT TO TAXABLE INCOME.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, for purposes of subsection (a) there shall be allowed as a deduction amounts used, or amounts irrevocably set aside (to the extent reasonable with reference to the size and terms of the indebtedness), to pay or retire qualified indebtedness.

"(2) CORPORATIONS TO WHICH APPLICABLE.—This subsection shall apply only with respect to a corporation—

"(A) which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year, or

"(B) to the extent that it succeeds to the deduction referred to in paragraph (1) by reason of section 381(c)(15).

"(3) QUALIFIED INDEBTEDNESS.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, for the purposes of this subsection the term 'qualified indebtedness' means—

"(i) the outstanding indebtedness incurred by the taxpayer after December 31, 1933, and before August 1, 1963, and

"(ii) the outstanding indebtedness incurred after July 31, 1963, for the purpose of making a payment or set-aside referred to in paragraph (1) in the same taxable year, but, in the case of such a payment or set-aside which is made on or after the first day of the first taxable year beginning after December 31, 1963, only to the extent the deduction otherwise allowed in paragraph (1) with respect to such payment or set-aside is treated as nondeductible by reason of the election provided in paragraph (4).

"(B) EXCEPTION.—For purposes of subparagraph (A), qualified indebtedness does not include any amounts which were, at any time after July 31, 1963, and before the payment or set-aside, owed to a person who at such time owned (or was considered as owning within the meaning of section 318(a)) more than 10 percent in value of the taxpayer's outstanding stock.

“(C) REDUCTION FOR AMOUNTS IRREVOCABLY SET ASIDE.—For purposes of subparagraph (A), the qualified indebtedness with respect to a contract shall be reduced by amounts irrevocably set aside before the taxable year to pay or retire such indebtedness; and no deduction shall be allowed under paragraph (1) for payments out of amounts so set aside.

“(4) ELECTION NOT TO DEDUCT.—A taxpayer may elect, under regulations prescribed by the Secretary or his delegate, to treat as nondeductible an amount otherwise deductible under paragraph (1); but only if the taxpayer files such election on or before the 15th day of the third month following the close of the taxable year with respect to which such election applies, designating therein the amounts which are to be treated as nondeductible and specifying the indebtedness (referred to in paragraph (3)(A)(ii)) incurred for the purpose of making the payment or set-aside.

“(5) LIMITATIONS.—The deduction otherwise allowed by this subsection for the taxable year shall be reduced by the sum of—

“(A) the amount, if any, by which—

“(i) the deductions allowed for the taxable year and all preceding taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, or amortization (other than such deductions which are disallowed in computing undistributed personal holding company income under subsection (b)(8)), exceed

“(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years, and

“(B) the amount, if any, by which—

“(i) the deductions allowed under subsection (b)(5) in computing undistributed personal holding company income for the taxable year and all preceding taxable years beginning after December 31, 1963, exceed

“(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years.

“(6) PRO-RATA REDUCTION IN CERTAIN CASES.—For purposes of paragraph (3)(A), if property (of a character which is subject to the allowance for exhaustion, wear and tear, obsolescence, or amortizations) is disposed of after July 31, 1963, the total amounts of qualified indebtedness of the taxpayer shall be reduced pro-rata in the taxable year of such disposition by the amount, if any, by which—

“(A) the adjusted basis of such property at the time of such disposition, exceeds

“(B) the amount of qualified indebtedness which ceased to be qualified indebtedness with respect to the taxpayer by reason of the assumption of the indebtedness by the transferee.”

(3) Paragraph (15) of section 381(c) (relating to carryovers in certain corporate acquisitions) is amended to read as follows:

“(15) INDEBTEDNESS OF CERTAIN PERSONAL HOLDING COMPANIES.—The acquiring corporation shall be considered to be the distributor or transferor corporation for the purpose of determining the applicability of subsections (b)(7) and (c) of section 545, relating to deduction with respect to payment of certain indebtedness.”

(j) INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY HOLDINGS.—

(1) IN GENERAL.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by redesignating section 1022 as section 1023 and by inserting after section 1021 the following new section:

“SEC. 1022. INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY HOLDINGS.

“(a) GENERAL RULE.—The basis (determined under section 1014(b)(5), relating to basis of stock or securities in a foreign personal holding company) of a share of stock or a security, acquired from a decedent dying after August 15, 1963, of a corporation which was a foreign personal holding company for its most recent taxable year ending before the date of the enactment of this section shall be increased by its proportionate share of any Federal estate tax attributable to the net appreciation in value of all of such shares and securities determined as provided in this section.

"(b) PROPORTIONATE SHARE.—For purposes of subsection (a), the proportionate share of a share of stock or of a security is that amount which bears the same ratio to the aggregate increase determined under subsection (c) (2) as the appreciation in value of such share or security bears to the aggregate appreciation in value of all such shares and securities having appreciation in value.

"(c) SPECIAL RULES AND DEFINITIONS.—For purposes of this section—

"(1) FEDERAL ESTATE TAX.—The term 'Federal estate tax' means only the tax imposed by section 2001 or 2101, reduced by any credit allowable with respect to a tax on prior transfers by section 2013 or 2102.

"(2) FEDERAL ESTATE TAX ATTRIBUTABLE TO NET APPRECIATION IN VALUE.—The Federal estate tax attributable to the net appreciation in value of all shares of stock and securities to which subsection (a) applies is that amount which bears the same ratio to the Federal estate tax as the net appreciation in value of all of such shares and securities bears to the value of the gross estate as determined under chapter 11 (including section 2032, relating to alternative valuation).

"(3) NET APPRECIATION.—The net appreciation in value of all shares and securities to which subsection (a) applies is the amount by which the fair market value of all such shares and securities exceeds the basis of such property in the hands of the decedent.

"(4) FAIR MARKET VALUE.—For purposes of this section, the term 'fair market value' means fair market value determined under chapter 11 (including section 2032, relating to alternate valuation).

"(d) LIMITATIONS.—This section shall not apply to any foreign personal holding company referred to in section 342(a) (2)."

(2) AMENDMENT OF SECTION 1016 (a).—Section 1016 (a) (relating to adjustments to basis) is amended by striking out the period at the end thereof and by inserting in lieu thereof a semicolon and by adding at the end thereof the following new paragraph:

"(21) to the extent provided in section 1022, relating to increase in basis for certain foreign personal holding company holdings, or in section 216(j) (4) of the Revenue Act of 1963."

(d) CLERICAL AMENDMENTS.—

(A) The table of sections for part II of subchapter O of chapter 1 is amended by striking out

"Sec. 1022. Cross references."

and inserting in lieu thereof the following:

"Sec. 1022. Increase in basis with respect to certain foreign personal holding company holdings.

"Sec. 1023. Cross references."

(4) ONE-MONTH LIQUIDATIONS.—If—

(A) a corporation was a foreign personal holding company for its most recent taxable year ending before the date of the enactment of this Act,

(B) all of the stock of such corporation is owned on August 15, 1963, and at the time of liquidation, by individuals and estates, and

(C) the transfer of all the property under the liquidation occurs within one of the first 4 calendar months ending after such date of enactment,

then such corporation shall be treated as a domestic corporation for purposes of section 333 of the Internal Revenue Code of 1954 (relating to 1-month liquidations), and shall be treated as a foreign corporation for purposes of section 367 of such Code (relating to foreign corporations). In applying such section 367 for purposes of this paragraph, references in the first sentence of such section 367 to other sections of such Code shall be treated as including a reference to such section 333.

(5) BASIS OF CERTAIN PROPERTY ACQUIRED FROM A DECEDENT.—

(A) In the case of property described in subparagraph (B) acquired from a decedent or passing from a decedent (within the meaning of section 1014(b) of the Internal Revenue Code of 1954), the basis shall (in lieu of being the basis provided by section 1014 of such Code) be the basis immediately before the death of the decedent, increased by the amount of any Federal estate tax attributable to the net appreciation in value of such property (determined in accordance with section 1022

of such Code as if such property were stock and securities referred to in such section).

(B) Subparagraph (A) shall apply to—

(i) property which the decedent received as a qualified electing shareholder, and

(ii) property the basis of which (without the application of this paragraph) is a substituted basis (as defined in section 1016(b) of the Internal Revenue Code of 1954) determined by reference to the basis of such property or other property received by any individual or estate as a qualified electing shareholder.

For purposes of this subparagraph, property shall be treated as property received as a qualified electing shareholder if, with respect to such property, the recipient was a qualified electing shareholder (within the meaning of section 333(c) of such Code) in a corporate liquidation to which section 333 of such Code applied by reason of paragraph (4) of this subsection.

(C) In the case of property acquired from the decedent by gift, the increase in basis under this paragraph shall not exceed the amount by which the increase under this paragraph is greater than the increase allowable under section 1015(d) of the Internal Revenue Code of 1954.

(6) LIMITATIONS.—The provisions of paragraphs (4) and (5) of this subsection shall not apply to any foreign corporation referred to in section 312(a) (2) of the Internal Revenue Code of 1954.

(7) MEANING OF TERMS.—Terms used in paragraphs (4) through (6) of this subsection shall have the same meaning as when used in chapter 1 of the Internal Revenue Code of 1954.

(k) TECHNICAL AMENDMENTS.—

(1) Section 542(b) (relating to corporations filing consolidated returns) is amended by striking out “gross income” each place it appears and inserting in lieu thereof “adjusted ordinary gross income”.

(2) Section 543 (relating to personal holding company income) is amended by striking out subsection (d) (relating to special adjustment on disposition of antitrust stock received as a dividend).

(3) Section 544 (relating to rules for determining stock ownership) is amended—

(A) by striking out “section 543(a) (5)” each place it appears and inserting in lieu thereof “section 543(a) (7)”, and

(B) by striking out “section 543(a) (9)” each place it appears and inserting in lieu thereof “section 543(a) (4)”.

(4) REAL ESTATE INVESTMENT TRUSTS.—Paragraph (6) of section 856(a) relating to definition of real estate investment trust is amended by striking out “gross income” and inserting in lieu thereof “adjusted ordinary gross income (as defined in section 543(b) (2))”.

(5) UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.—Section 1361(i) (relating to personal holding company income) is amended to read as follows:

“(i) PERSONAL HOLDING COMPANY INCOME.—

“(1) EXCLUDED FROM INCOME OF ENTERPRISE.—There shall be excluded from the gross income of the enterprise as to which an election has been made under subsection (a) any item of gross income (computed without regard to the adjustments provided in section 543(b) (3) or (4)) if, but for this paragraph, such item (adjusted, where applicable, as provided in section 543(b) (3) or (4)) would constitute personal holding company income, (as defined in section 543(a)) of such enterprise.

“(2) INCOME AND DEDUCTIONS OF OWNERS.—Items excluded from the gross income of the enterprise under paragraph (1), and the expenses attributable thereto, shall be treated as the income and deductions of the proprietor or partners (in accordance with their distributive shares of partnership income) of such enterprise.

“(3) DISTRIBUTIONS.—If—

“(A) the amount excluded from gross income under paragraph (2) exceeds the expenses attributable thereto, and

“(B) any portion of such excess is distributed to the proprietor or partner during the year earned,

such portion shall not be taxed as a corporate distribution. The portion of such excess not distributed during such year shall be considered as paid-in surplus or as a contribution to capital as of the close of such year."

(6) **ASSESSMENT AND COLLECTION OF PERSONAL HOLDING COMPANY TAX.**—Section 6501(f) (relating to personal holding company tax) is amended by striking out "gross income, described in section 543(a)," and inserting in lieu thereof "gross income and adjusted ordinary income, described in section 543."

(1) **EFFECTIVE DATES.**—

(1) The amendments made by this section (other than by subsections (c) (1), (f), (g), and (j)) shall apply to taxable years beginning after December 31, 1963.

(2) The amendment made by subsection (c) (1) shall apply to taxable years beginning after October 16, 1962.

(3) The amendments made by subsections (f) and (g) shall apply to distributions made in any taxable year of the distributing corporation beginning December 31, 1963.

(4) The amendments made by paragraphs (1), (2), and (3) of subsection (j) shall apply in respect of decedents dying after August 15, 1963.

(5) Subsection (h) shall apply to taxable years beginning after December 31, 1963.

**SEC. 217. TREATMENT OF PROPERTY IN CASE OF OIL AND GAS WELLS.**

(a) **IN GENERAL.**—Section 614(b) (relating to special rule as to operating mineral interests) is amended to read as follows:

"(b) **SPECIAL RULES AS TO OPERATING MINERAL INTERESTS IN OIL AND GAS WELLS.**—In the case of oil and gas wells—

"(1) **IN GENERAL.**—Except as otherwise provided in this subsection—

"(A) all of the taxpayer's operating mineral interests in a separate tract or parcel of land shall be combined and treated as one property, and

"(B) the taxpayer may not combine an operating mineral interest in one tract or parcel of land with an operating mineral interest in another tract or parcel of land.

"(2) **ELECTION TO TREAT OPERATING MINERAL INTERESTS AS SEPARATE PROPERTIES.**—If the taxpayer has more than one operating mineral interest in a single tract or parcel of land, he may elect to treat one or more of such operating mineral interests as separate properties. The taxpayer may not have more than one combination of operating mineral interests in a single tract or parcel of land. If the taxpayer makes the election provided in this paragraph with respect to any interest in a tract or parcel of land, each operating mineral interest which is discovered or acquired by the taxpayer in such tract or parcel of land after the taxable year for which the election is made shall be treated—

"(A) if there is no combination of interests in such tract or parcel, as a separate property unless the taxpayer elects to combine it with another interest, or

"(B) if there is a combination of interests in such tract or parcel, as part of such combination unless the taxpayer elects to treat it as a separate property.

"(3) **CERTAIN UNITIZATION OR POOLING ARRANGEMENTS.**—

"(A) **IN GENERAL.**—Under the regulations prescribed by the Secretary or his delegate, if one or more of the taxpayer's operating mineral interests participate, under a voluntary or compulsory unitization or pooling agreement, in a single cooperative or unit plan of operation, then for the period of such participation—

"(i) they shall be treated for all purposes of this subtitle as one property, and

"(ii) the application of paragraphs (1), (2), and (4) in respect of such interests shall be suspended.

"(B) **LIMITATION.**—Subparagraph (A) shall apply to a voluntary agreement only if all the operating mineral interests covered by such agreement—

"(i) are in the same deposit, or are in 2 or more deposits the joint development or production of which is logical from the standpoint of geology, convenience, economy, or conservation, and

"(ii) are in tracts or parcels of land which are contiguous or in close proximity.

"(C) SPECIAL RULE IN THE CASE OF ARRANGEMENTS ENTERED INTO IN TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1964.—If—

"(i) two or more of the taxpayer's operating mineral interests participate under a voluntary or compulsory unitization or pooling agreement entered into in any taxable year beginning before January 1, 1964, in a single cooperative or unit plan of operation,

"(ii) the taxpayer, for the last taxable year beginning before January 1, 1964, treated such interests as two or more separate properties, and

"(iii) it is determined that such treatment was proper under law applicable to such taxable year,

such taxpayer may continue to treat such interests in a consistent manner for the period of such participation.

"(4) MANNER, TIME, AND SCOPE OF ELECTION.—

(A) MANNER AND TIME.—Any election provided in paragraph (2) shall be made for each operating mineral interests, in the manner prescribed by the Secretary or his delegate by regulations, not later than the time prescribed by law for filing the return (including extensions thereof) for whichever of the following taxable years is the later: The first taxable year beginning after December 31, 1963, or the first taxable year in which any expenditure for development or operation in respect of such operating mineral interests is made by the taxpayer after the acquisition of such interest.

"(B) SCOPE.—Any election under paragraph (2) shall be for all purposes of this subtitle and shall be binding on the taxpayer for all subsequent taxable years.

"(5) TREATMENT OF CERTAIN PROPERTIES.—If, on the day preceding the first day of the first taxable year beginning after December 31, 1963, the taxpayer has any operating mineral interests which he treats under subsection (d) of this section (as in effect before the amendments made by the Revenue Act of 1963), such treatment shall be continued and shall be deemed to have been adopted pursuant to paragraphs (1) and (2) of this subsection (as amended by such Act)."

(b) TECHNICAL AMENDMENTS.—

(1) The heading of section 614(c) is amended to read as follows:

"(c) SPECIAL RULES AS TO OPERATING MINERAL INTERESTS IN MINES.—"

(2) Paragraph (5) of section 614(c) is hereby repealed.

(3) Section 614(d) is amended to read as follows:

"(d) OPERATING MINERAL INTERESTS DEFINED.—For purposes of this section, the term 'operating mineral interest' includes only an interest in respect of which the costs of production of the mineral are required to be taken into account by the taxpayer for purposes of computing the 50 percent limitation provided for in section 613, or would be so required if the mine, well, or other natural deposit were in the production stage."

(4) Section 614(e)(2) is amended by striking out "within the meaning of subsection (b)(3)".

(c) ALLOCATION OF BASIS IN CERTAIN CASES.—For purposes of the Internal Revenue Code of 1954—

(1) FAIR MARKET VALUE RULE.—Except as provided in paragraph (2), if a taxpayer has a section 614(b) aggregation, then the adjusted basis (as of the first day of the first taxable year beginning after December 31, 1963) of each property included in such aggregation shall be determined by multiplying the adjusted basis of the aggregation by a fraction—

(A) the numerator of which is the fair market value of such property, and

(B) the denominator of which is the fair market value of such aggregation.

For purposes of this paragraph, the adjusted basis and the fair market value of the aggregation, and the fair market value of each property included therein, shall be determined as of the day preceding the first day of the first taxable year which begins after December 31, 1963.

(2) ALLOCATION OF ADJUSTMENTS, ETC.—If the taxpayer makes an election under this paragraph with respect to any section 614(b) aggregation, then the adjusted basis (as of the first day of the first taxable year beginning



after December 31, 1963) of each property included in such aggregation shall be the adjusted basis of such property at the time it was first included in the aggregation by the taxpayer, adjusted for that portion of those adjustments to the basis of the aggregation which are reasonably attributable to such property. If, under the preceding sentence, the total of the adjusted bases of the interests included in the aggregation exceeds the adjusted basis of the aggregation (as of the day preceding the first day of the first taxable year which begins after December 31, 1963), the adjusted bases of the properties which include such interests shall be adjusted, under regulations prescribed by the Secretary of the Treasury or his delegate, so that the total of the adjusted bases of such interests equals the adjusted basis of the aggregation. An election under this paragraph shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall by regulations prescribe.

(3) DEFINITIONS.—For purposes of this subsection—

(A) SECTION 614(b) AGGREGATION.—The term “section 614(b) aggregation” means any aggregation to which section 614(b) (1) (A) of the Internal Revenue Code of 1954 (as in effect before the amendments made by subsection (a) of this section) applied for the day preceding the first day of the first taxable year beginning after December 31, 1963.

(B) PROPERTY.—The term “property” has the same meaning as is applicable, under section 614 of the Internal Revenue Code of 1954, to the taxpayer for the first taxable year beginning after December 31, 1963.

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1963.

#### SEC. 218. TREATMENT OF CERTAIN IRON ORE ROYALTIES.

(a) IN GENERAL.—

(1) AMENDMENT OF SECTION 631(c).—Section 631(c) (relating to disposal of coal with a retained economic interest) is amended—

(A) by striking out the heading and inserting in lieu thereof the following:

“(c) DISPOSAL OF COAL OR IRON ORE WITH A RETAINED ECONOMIC INTEREST.—”;

(B) by inserting “or iron ore” after “coal (including lignite)”;

and

(C) by inserting “or iron ore” after “coal” each other place it appears in section 631(c).

(2) AMENDMENT OF SECTION 1231(b).—Section 1231(b) (2) (defining property used in the trade or business) is amended to read as follows:

“(2) TIMBER, COAL, OR IRON ORE.—Such term includes timber, coal, and iron ore with respect to which section 631 applies.”

(3) AMENDMENT OF SECTION 272.—The text of section 272 (relating to disposal of coal) is amended by inserting “or iron ore” after “coal” each place it appears.

(b) CLERICAL AMENDMENTS.—

(1) the heading of section 631 is amended to read as follows:

“SEC. 631. GAIN OR LOSS IN THE CASE OF TIMBER, COAL, OR IRON ORE.”

(2) The table of sections for part III of subchapter I of chapter 1 is amended by striking out

“Sec. 631. Gain or loss in the case of timber or coal.”

and inserting in lieu thereof the following:

“Sec. 631. Gain or loss in the case of timber, coal, or iron ore.”

(3) The heading of section 272 is amended to read as follows:

“SEC. 272. DISPOSAL OF COAL OR IRON ORE.”

(4) The table of sections for part IX of subchapter B of chapter 1 is amended by striking out

“Sec. 272. Disposal of coal.”

and inserting in lieu thereof the following:

“Sec. 272. Disposal of coal or iron ore.”

(5) Section 1016(a) (15) is amended by inserting “or iron ore” after “coal”.

(6) Section 1402(a)(3)(B) is amended to read as follows:

"(B) from the cutting of timber, or the disposal of timber, coal, or iron ore, if section 631 applies to such gain or loss, or"

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to iron ore mined in taxable years beginning after December 31, 1963.

#### SEC. 219. CAPITAL GAINS AND LOSSES.

(a) ALTERNATIVE TAX, ETC.—

(1) IN GENERAL.—

(A) ALTERNATIVE TAX.—Subsection (b) of section 1201 (relating to alternative tax on taxpayers other than corporation) is amended to read as follows:

"(b) OTHER TAXPAYERS.—If, for any taxable year, a taxpayer (other than a corporation) is allowed a deduction under section 1202, then, in lieu of the tax imposed by sections 1 and 511(b), there is hereby imposed a tax (if such a tax is less than the tax imposed by such sections) which shall consist of the sum of—

"(1) a partial tax computed on the taxable income reduced by an amount equal to the sum of—

"(A) 40 percent of the adjusted class A capital gain, and

"(B) 50 percent of the adjusted class B capital gain,

plus

"(2) an amount equal to the sum of—

"(A) 21 percent of the adjusted class A capital gain, and

"(B) 25 percent of the adjusted class B capital gain."

(B) DEDUCTION FOR CAPITAL GAINS.—Section 1202 (relating to deduction for capital gains) is amended to read as follows:

#### "SEC. 1202. DEDUCTION FOR CAPITAL GAINS.

"(a) GENERAL RULE.—In the case of a taxpayer other than a corporation, a deduction from gross income shall be allowed equal to the sum of—

"(1) 60 percent of the adjusted class A capital gain, and

"(2) 50 percent of the adjusted class B capital gain.

"(b) SPECIAL RULE.—In the case of an estate or trust, the deduction allowable under subsection (a) shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets."

"(c) DEFINITIONS.—Section 1222 (relating to other terms relating to capital gains and losses) is amended to read as follows:

#### "SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

"(a) TERMS APPLICABLE TO ALL TAXPAYERS.—For purposes of this subtitle—

"(1) SHORT-TERM CAPITAL GAIN.—The term 'short-term capital gain' means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing gross income.

"(2) SHORT-TERM CAPITAL LOSS.—The term 'short-term capital loss' means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent that such loss is taken into account in computing taxable income.

"(3) NET SHORT-TERM CAPITAL GAIN.—The term 'net short-term capital gain' means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year.

"(4) NET SHORT-TERM CAPITAL LOSS.—The term 'net short-term capital loss' means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year.

"(b) TERMS APPLICABLE TO CORPORATIONS.—For purposes of this subtitle, in the case of a corporation—

"(1) LONG-TERM CAPITAL GAIN.—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

"(2) LONG-TERM CAPITAL LOSS.—The term 'long-term capital loss' means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent that such loss is taken into account in computing taxable income.

"(3) NET LONG-TERM CAPITAL GAIN.—The term 'net long-term capital gain' means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year.

"(4) NET LONG-TERM CAPITAL LOSS.—The term 'net long-term capital loss' means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

"(5) NET CAPITAL GAIN.—The term 'net capital gain' means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

"(6) NET CAPITAL LOSS.—The term 'net capital loss' means the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 1211(a). For purposes of determining losses under this paragraph, amounts which are short-term capital losses under section 1212 shall be excluded.

"(c) TERMS APPLICABLE TO TAXPAYERS OTHER THAN CORPORATIONS.—For purposes of this subtitle, in the case of a taxpayer other than a corporation—

"(1) CLASS B CAPITAL GAIN.—The term 'class B capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years, if and to the extent such gain is taken into account in computing gross income.

"(2) CLASS B CAPITAL LOSS.—The term 'class B capital loss' means loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years, if and to the extent that such loss is taken into account in computing taxable income.

"(3) CLASS A CAPITAL GAIN.—The term 'class A capital gain' means gain from the sale or exchange of a capital asset held for more than 2 years, if and to the extent such gain is taken into account in computing gross income.

"(4) CLASS A CAPITAL LOSS.—The term 'class A capital loss' means loss from the sale or exchange of a capital asset held for more than 2 years, if and to the extent that such loss is taken into account in computing taxable income.

"(5) NET CLASS B CAPITAL GAIN.—The term 'net class B capital gain' means the excess of class B capital gains for the taxable year over the class B capital losses for such year.

"(6) NET CLASS B CAPITAL LOSS.—The term 'net class B capital loss' means the excess of class B capital losses for the taxable year over the class B capital gains for such year.

"(7) NET CLASS A CAPITAL GAIN.—The term 'net class A capital gain' means the excess of class A capital gains for the taxable year over the class A capital losses for such year.

"(8) NET CLASS A CAPITAL LOSS.—The term 'net class A capital loss' means the excess of class A capital losses for the taxable year over the class A capital gains for such year.

"(9) ADJUSTED CLASS B CAPITAL GAIN.—The term 'adjusted class B capital gain' means the net class B capital gain for the taxable year reduced by losses which reduce such net gain as provided in subsection (d).

"(10) ADJUSTED CLASS A CAPITAL GAIN.—The term 'adjusted class A capital gain' means the net class A capital gain for the taxable year reduced by losses which reduce such net gain as provided in subsection (d).

"(d) RULES FOR REDUCING NET CAPITAL GAINS BY CAPITAL LOSSES.—For purposes of paragraphs (9) and (10) of subsection (c) and for purposes of reducing any net short-term capital gain, if for a taxable year a taxpayer (other than a corporation) has a net short-term, net class B, or net class A capital loss, such loss shall reduce any net short-term, net class B, or net class A capital gain for such year by applying paragraph (1), then paragraph (2), and then paragraph (3):

"(1) A net class A capital loss shall reduce first any net class B capital gain and then any net short-term capital gain.

"(2) A net class B capital loss shall reduce first any net class A capital gain and then any net short-term capital gain.

"(3) A net short-term capital loss shall reduce first any net class B capital gain and then any net class A capital gain."

(2) PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.—

(A) Subsection (a) of section 1231 (relating to property used in a trade or business) is amended to read as follows:

“(a) GENERAL RULE.—If, during the taxable year—

“(1) the recognized gains from sales or exchanges of property used in the trade or business, plus

“(2) the recognized gains from the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and of capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, each such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.”

(B) Section 1231 is amended by adding at the end thereof the following new subsection:

“(c) SPECIAL RULES.—

“(1) GAINS AND LOSSES TAKEN INTO ACCOUNT.—For purposes of subsection (a)—

“(A) Any gain described in subsection (a) shall be included—

“(i) only if and to the extent taken into account in computing gross income, and

“(ii) only to the extent not required (by any provision of this subtitle other than this section) to be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in this section.

“(B) Losses described in subsection (a) shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply.

“(C) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business and held for more than 6 months, or of a capital asset held for more than 6 months, shall be considered losses from a compulsory or involuntary conversion.

“(2) CERTAIN LOSSES FROM CASUALTY OR THEFT.—In the case of any property used in the trade or business, and in the case of any capital asset held for more than 6 months and held for the production of income, subsection (a) shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty or from theft.

“(3) GAINS AND LOSSES TREATED AS CLASS B GAINS AND LOSSES.—In the case of a taxpayer other than a corporation, gain or loss—

“(A) from a sale, exchange, or conversion of property to which subsection (b) (2), (3), or (4) applies, and

“(B) which by reason of subsection (a) is considered as gain or loss from the sale or exchange of a capital asset, shall be considered as class B capital gain or loss whether or not such property was held for more than 2 years.”

(3) CERTAIN DISTRIBUTIONS UNDER EMPLOYEES' TRUSTS AND ANNUITY PLANS.—

(A) DISTRIBUTION UNDER EMPLOYEES' TRUSTS.—Section 402(a) (relating to taxability of beneficiary of exempt trust) is amended—

(1) by adding at the end of paragraph (1) the following new sentence: “Any gain on the subsequent sale or other disposition of any such security by the distributee (or by any other person in whose hands the basis of such security is determined by reference to the basis of the security in the hands of the distributee) shall, to the extent of the amount of such net unrealized appreciation attributable to such security, be considered a gain from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years.”;

(ii) by adding immediately before the period at the end of the first sentence of paragraph (2) the words “but not more than 2 years”; and

(iii) by adding immediately before the last sentence of paragraph (2) the following new sentence: "Any gain on the subsequent sale or other disposition of any such security by the distributee (or by any other person in whose hands the basis of such security is determined by reference to the basis of the security in the hands of the distributee) shall, to the extent of the amount of such net unrealized appreciation attributable to such security, be considered a gain from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years."

(B) DISTRIBUTIONS UNDER EMPLOYEE ANNUITIES.—Section 403(a) (2)(A) (relating to capital gains treatment for certain distributions) is amended by adding immediately before the period at the end of the first sentence the words "but not more than 2 years".

(C) EFFECTIVE DATE.—

(i) The amendments made by subparagraphs (A) (ii) and (B) shall apply with respect to distributions or amounts paid in taxable years of the distributees beginning after December 31, 1963.

(ii) The amendments made by subparagraphs (A) (i) and (iii) shall apply with respect to securities which are sold or otherwise disposed of in taxable years beginning after December 31, 1963.

(4) SALE OR EXCHANGE OF PATENTS.—Subsection (a) of section 1235 (relating to the sale or exchange of patents) is amended by adding at the end thereof the following new sentences:

"In the case of a holder described in subsection (b) (1), any gain or loss on such a transfer shall be treated as class B capital gain or loss. In the case of a holder described in subsection (b) (2), any gain or loss on such a transfer shall be treated as class A, or class B, capital gain or loss, depending on the period for which the property was held (or deemed held)."

(5) EMPLOYEE TERMINATION PAYMENTS.—Section 1240 (relating to taxability to employee of termination payments) is amended by striking out "6 months" and inserting in lieu thereof "6 months but not more than 2 years".

(b) UNLIMITED CAPITAL LOSS CARRYOVER.—Section 1212 (relating to capital loss carryover) is amended—

(1) by striking out "If for any taxable year the taxpayer" and inserting in lieu thereof:

"(a) CORPORATIONS.—If for any taxable year a corporation"; and

(2) by adding the following new subsection:

"(b) OTHER TAXPAYERS.—

"(1) To the extent, for any taxable year, a taxpayer, other than a corporation, has a net short-term, net class B, or net class A capital loss which does not reduce capital gains under the rules provided in section 1222(d), such loss, reduced as provided in paragraph (2), shall be carried forward and treated in the succeeding taxable year as a short-term, class B, or class A capital loss, as the case may be, sustained in such succeeding year.

"(2) An amount equal to the excess of the sum allowable under section 1211(b) over gains from sales or exchanges of capital assets for the taxable year shall reduce, in order, any net short-term, class B, or class A capital loss for the taxable year which does not reduce capital gains for such year under the rules provided in section 1222(d).

"(3) For purposes of this subsection, a net capital loss for a taxable year beginning before January 1, 1964, shall be determined under the applicable law relating to the computation of capital gains and losses in effect before such date, and the amount of any such capital loss so determined which such loss such applicable law allows to be carried over to the first taxable year of the taxpayer beginning after December 31, 1963, shall be treated as a short-term capital loss occurring in such taxable year."

(c) TECHNICAL AMENDMENTS.—

(1) Section 172(d) (2) (B) (relating to net operating loss deduction) is amended by striking out "long-term."

(2) Section 333(e) (2) (relating to noncorporate shareholders of certain liquidating corporations) is amended by striking out "short-term or long-term capital gain." and inserting in lieu thereof "short-term, class A, or class B capital gain."

(3) Section 341(a) (relating to collapsible corporations) is amended by striking out "6 months" and inserting in lieu thereof "6 months but not more than 2 years or held for more than 2 years, as the case may be,".

(4) Section 584(c) (1) (relating to common trust funds) is amended—

(A) by striking out in subparagraph (B) wherever it appears "6 months" and inserting in lieu thereof "6 months but not more than 2 years", and

(B) by redesigning subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) as part of its gains and losses from sales or exchanges of capital assets held for more than 2 years, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than 2 years;".

(5) Section 642(c) (relating to special rules for credits and deductions) is amended by striking out "6 months," and inserting in lieu thereof "6 months but not more than 2 years or held for more than 2 years, as the case may be,".

(6) Section 702(a) (2) (relating to income and credits of partners) is amended by striking out "6 months," and inserting in lieu thereof "6 months but not more than 2 years or held for more than 2 years, as the case may be,".

(7) (A) Section 852 (relating to taxation of regulated investment companies and their shareholders) is amended by striking out subparagraphs (B) and (C) of subsection (b) (3) and inserting in lieu thereof the following:

"(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by shareholders, other than corporations, as a class A or class B capital gain to the extent so designated by the company. Shareholders which are corporations shall treat a capital gain dividend as a long-term capital gain.

"(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the company in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year, as a distribution of class A or class B capital gain. In the case of a shareholder which is a corporation, if the aggregate amount designated as a capital gain dividend with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. In the case of a shareholder other than a corporation, if the aggregate amount designated as class A capital gain, or as class B capital gain with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the adjusted class A, or adjusted class B capital gain, respectively—

"(i) the portion of each distribution which shall be treated as a class A capital gain shall be only that proportion of the amount so designated as class A capital gain which the adjusted class A capital gain bears to the aggregate amount so designated, and

"(ii) the portion of each distribution which shall be treated as a class B capital gain shall be only that proportion of the amount so designated as class B capital gain which the adjusted class B capital gain bears to the aggregate amount so designated.

For purposes of the preceding sentence, the adjusted class A or adjusted class B capital gain shall be computed as though the company were a taxpayer other than a corporation except that section 1212(a) shall apply in lieu of section 1212(b)."

(B) Section 852(b) (3) (D) is amended by striking out clauses (i), (ii), and (iii) and inserting in lieu thereof the following:

"(i) Every shareholder of a regulated investment company at the close of the company's taxable year shall, in the case of a corporation, in computing its long-term capital gains, and, in the case

of a shareholder other than a corporation, in computing his class A and class B capital gains, include in his return for his taxable year in which the last day of the company's taxable year falls, such amounts as the company shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 30 days after the close of its taxable year, but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A) which he would have received if all of such amount had been distributed as capital gain dividends by the company to the holders of such shares at the close of its taxable year.

"(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax of 25 percent imposed by subparagraph (A) on the amounts required by this subparagraph to be included in respect of such shares, in the case of a corporation, in computing its long-term capital gains, and, in the case of a shareholder other than a corporation, in computing his class A and class B capital gains, for that year; and such shareholder shall be allowed credit or refund, as the case may be, for the tax so deemed to have been paid by him.

"(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased by 75 percent of the amounts required by this subparagraph to be included in computing his capital gains."

(C) Section 852(b) (4) is amended to read as follows:

"(4) LOSS ON SALE OR EXCHANGE OF STOCK HELD LESS THAN 31 DAYS.—If, under subparagraph (B) or (D) of paragraph (3) a shareholder of a regulated investment company is required, with respect to any share, to treat any amount as a long-term, class A, or class B capital gain, and such share is held by the taxpayer for less than 31 days, then any loss on the sale or exchange of such share shall—

"(A) in the case of a corporation, to the extent of such long-term capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 6 months, or

"(B) in the case of a shareholder other than a corporation—

"(i) to the extent of such class A capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 2 year, and

"(ii) to the extent of such class B capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years.

If there is a loss on the sale or exchange of such share which is less than the sum of such class A and class B capital gains, then a portion of such loss equal to the proportion which such class A capital gains bears to the sum of such class A and class B capital gains shall be a class A capital loss; and the remainder of such loss shall be a class B capital loss.

For purposes of this paragraph, the rules of section 246(c) (3) shall apply in determining whether any share of stock has been held for less than 31 days; except that '30 days' shall be substituted for '15 days' in subparagraph (B) of section 246(c) (3)."

(8) (A) Section 857 (relating to the taxation of real estate investment trusts and their beneficiaries) is amended by striking out subparagraphs (B) and (C) of subsection (b) (3) and inserting in lieu thereof the following:

"(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders or holders of beneficial interests, other than corporations, as a class A or class B capital gain to the extent so designated by the real estate investment trust. Shareholders or holders of beneficial interests which are corporations shall treat a capital gain dividend as a long-term capital gain.

"(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—For purposes of this part, a capital gain dividend is any dividend, or part thereof, which is designated by the real estate investment trust in a written notice mailed to its shareholders or holders of beneficial interests at any time before the expiration of 30 days after the close of its taxable year as a distri-

bution of class A or class B capital gain. In the case of a shareholder or holder of beneficial interest which is a corporation, if the aggregate amount designated as a capital gain dividend with respect to a taxable year of the trust (including capital gain dividends paid after the close of the taxable year described in section 858) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. In the case of a shareholder or holder of a beneficial interest other than a corporation, if the aggregate amount designated as class A or as class B capital gain with respect to a taxable year of the trust (including capital gains dividends paid after the close of the taxable year described in section 858) is greater than the adjusted class A or adjusted class B capital gain, respectively—

“(1) the portion of each distribution which shall be treated as a class A capital gain shall be only that proportion of the amount so designated as class A capital gain which the adjusted class A capital gain bears to the aggregate amount so designated, and

“(ii) the portion of each distribution which shall be treated as a class B capital gain shall be only that portion of the amount so designated as class B capital gain which the adjusted class B capital gain bears to the aggregate amount so designated.

For purposes of the preceding sentence, the adjusted class A or class B capital gain shall be computed as though the trust were a taxpayer other than a corporation except that section 1212(a) shall apply in lieu of section 1212(b).”

(B) Section 857 is amended by striking out paragraph (4) of subsection (b) and inserting in lieu thereof the following:

“(4) LOSS ON SALE OR EXCHANGE OF STOCK HELD LESS THAN 31 DAYS.—If, under subparagraph (B) of paragraph (3) a shareholder or, or a holder of a beneficial interest in, a real estate investment trust is required, with respect to any share or beneficial interest, to treat any amount as a long-term, class A, or class B capital gain, and such share or interest is held by the taxpayer for less than 31 days, then any loss on the sale or exchange of such share or interest shall—

“(A) in the case of a corporation, to the extent of such long-term capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 6 months, or

“(B) in the case of a shareholder other than a corporation—

“(i) to the extent of such class A capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 2 years, and

“(ii) to the extent of such class B capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years.

If there is a loss on the sale or exchange of such share or interest which is less than the sum of such class A and class B capital gains, then a portion of such loss equal to the proportion which such class A capital gain bears to the sum of such class A and class B capital gains shall be a class A capital loss; and the remainder of such loss shall be a class B capital loss.

For purposes of this paragraph, the rules of section 246(c) (3) shall apply in determining whether any share of stock or beneficial interest has been held for less than 31 days; except that ‘30 days’ shall be substituted for ‘15 days’ in subparagraph (B) of section 246(c) (3).”

(9) The last sentence of section 1232(a) (2) (A) (relating to bonds and other evidences of indebtedness) is amended to read as follows: “Gains in excess of such amount shall, in the case of a corporation, be considered gain from the sale or exchange of a capital asset held more than 6 months or in the case of a taxpayer other than a corporation, be considered gain from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years or held for more than 2 years, as the case may be.”



(10) (A) Subsection (b) of section 1233 (relating to gains and losses from short sales) is amended to read as follows:

"(b) **SHORT-TERM AND CLASS B GAINS AND HOLDING PERIODS.**—If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer—

"(1) for not more than 6 months (determined without regard to the effect, under the second sentence of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof, any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 6 months (notwithstanding the period of time any property used to close such short sale has been held); or

"(2) in the case of a taxpayer other than a corporation, for more than 6 months but not more than 2 years (determined without regard to the effect, under the second sentence of this subsection, of such short sale on the holding period), any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for more than 6 months but not more than 2 years (notwithstanding the period of time any property used to close such short sale has been held).

The holding period of such substantially identical property shall be considered to begin (notwithstanding section 1223, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. The preceding sentence shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short. For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale."

(B) Subsection (d) of section 1233 is amended to read as follows:

"(d) **LONG-TERM, CLASS A, AND CLASS B LOSSES.**—If on the date of such short sale substantially identical property has been held by the taxpayer—

"(1) In the case of a corporation, for more than 6 months, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 6 months (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234).

"(2) In the case of a taxpayer other than a corporation—

"(A) for more than 2 years, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 2 years (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234), or

"(B) for more than 6 months but not more than 2 years, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 6 months but not more than 2 years (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234)."

(C) Paragraph (1) of section 1233(e) is amended to read as follows:

"(1) Subsection (b) or (d) shall not apply to the gain or loss, respectively, on any quantity of property used to close such short sale which is in excess of the quantity of the substantially identical property referred to in the applicable subsection. In the case of a taxpayer other than a corporation—

"(A) subsection (b) (1) or (d) (2) (A) shall not apply to the gain or loss, respectively, on any quantity of property used to close such short sale which is in excess of the quantity of the substantially identical property to which either subsection (b) (1) or (d) (2) (A) applies (determined without regard to this subparagraph), and

"(B) subsection (b) (2) or (d) (2) (B) shall apply only to the gain or loss, respectively, on the excess described in subparagraph (A), but only to the extent of the quantity of the substantially identical property to which either subsection (b) (2) or (d) (2) (B) applies (determined without regard to this subparagraph)."

(D) Section 1233(e)(4)(A) is amended by striking out "for not more than 6 months," in clause (1) and inserting in lieu thereof "in the case of a corporation, for not more than 6 months, or in the case of a taxpayer other than a corporation, for not more than 2 years," and by striking out "subsection (b)(2)" in the language following clause (ii) and inserting in lieu thereof "the second and third sentences of subsection (b)".

(E) Section 1233(f) is amended by striking out "subsection (b)(2)" each place it appears and inserting in lieu thereof "the second and third sentences of subsection (b)".

(11) (A) Section 1247 (relating to election by foreign investment companies to distribute income currently) is amended by striking out subparagraph (B) of subsection (a)(1) and inserting in lieu thereof the following:

"(B) designate in a written notice mailed to its shareholders at any time before the expiration of 45 days after the close of its taxable year the pro rata amount for the taxable year of the adjusted class A and adjusted class B capital gain (determined as though such corporation were a taxpayer other than a corporation except that section 1212 (a) shall apply in lieu of section 1212(b)); and the portions thereof which are being distributed; and"

(B) Clause (i) of section 1247(a)(2)(A) is amended to read as follows:

"(i) the adjusted class A and adjusted class B capital gain referred to in paragraph (1)(B),"

(C) Subparagraph (C) of section 1247(a)(2) is amended to read as follows:

"(C) CARRYOVER OF CAPITAL LOSSES FROM NONELECTION YEARS DENIED.—In computing the adjusted class A and adjusted class B capital gains referred to in paragraph (1)(B), section 1212 shall not apply to losses incurred in or with respect to taxable years before the first taxable year to which the election applies."

(D) Section 1247(c)(2) is amended by striking out "his long-term capital gains" and inserting in lieu thereof "in the case of a shareholder which is a corporation, its long-term capital gains, and in the case of a shareholder other than a corporation, his class A and class B capital gains";

(E) Subsection (d) of section 1247 is amended to read as follows:

"(d) TREATMENT OF DISTRIBUTED AND UNDISTRIBUTED CAPITAL GAINS BY A QUALIFIED SHAREHOLDER.—Every qualified shareholder of a foreign investment company for any taxable year of such company with respect to which an election pursuant to subsection (a) is in effect shall—

"(1) if such shareholder is a taxpayer other than a corporation—

"(A) include in computing his class A or class B capital gain for his taxable year in which received, his pro rata share of the distributed portion of the adjusted class A or adjusted class B capital gain, respectively, and

"(B) include in computing his class A or class B capital gain for his taxable year in which or with which the taxable year of such company ends, his pro rata share of the undistributed portion of the adjusted class A or adjusted class B capital gain, respectively, or

"(2) if such shareholder is a corporation, include in computing its long-term capital gains—

"(A) for its taxable year in which received, its pro rata share of the distributed portion of the sum of the adjusted class A and adjusted class B capital gains, and

"(B) for its taxable year in which or with which the taxable year of such company ends, its pro rata share of the undistributed portion of the sum of the adjusted class A and adjusted class B capital gains.

For purposes of this subsection the adjusted class A and adjusted class B capital gains shall be determined as provided in subsection (a)(1)(B)."

(F) Subsection (i) of section 1247 is amended to read as follows:

"(1) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK.—

"(1) SHAREHOLDERS OTHER THAN CORPORATIONS.—If, under this section, any qualified shareholder other than a corporation treats any amount designated under subsection (a)(1)(B) with respect to a share of stock as—

"(A) class B capital gain and such share is held by the taxpayer for 6 months or less, then any loss on the sale or exchange of such share shall, to the extent of the amount treated as class B capital gain, be

treated as a loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years,

"(B) class A capital gain and such share is held by the taxpayer for 2 years or less, then any loss on the sale or exchange of such share shall, to the extent of the amount treated as class A capital gain, be treated as a loss from the sale or exchange of a capital asset held for more than 2 years, or

"(C) both class A and class B capital gains and such share is held by the taxpayer for 6 months or less and there is a loss on the sale or exchange of such stock which is less than the sum of the amount so designated, then an amount of such loss shall be treated as a loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years which bears the same relation to such loss as the class B capital gain so designated bears to the sum of such class B and the class A capital gains so designated; and the remainder of such loss shall be treated as a loss from the sale or exchange of a capital asset held for more than 2 years.

"(2) CORPORATE SHAREHOLDERS.—If, under this section, any qualified shareholder which is a corporation treats any amount designated under subsection (a) (1) (B) with respect to a share of stock as long-term capital gain and such share is held by the taxpayer for 6 months or less, then any loss on the sale or exchange of such share shall, to the extent of the amount treated as long-term capital gain, be treated as a loss from the sale or exchange of a capital asset held for more than 6 months."

(12) Section 1248(b) (relating to gain from certain sales or exchanges of stock in certain foreign corporations) is amended by striking out "6 months." each place it appears and inserting in lieu thereof "6 months but not more than 2 years or held for more than 2 years, as the case may be,".

(13) Section 1375(a) (relating to special rules applicable to capital gains of electing small business corporations) is amended to read as follows:

"(a) CAPITAL GAINS.—

"(1) TREATMENT IN HANDS OF SHAREHOLDERS.—The amount includible in the gross income of a shareholder as dividends (including amounts treated as dividends under section 1373(b)) from an electing small business corporation during any taxable year of the corporation, to the extent such amount is a distribution of property out of earnings and profits of the taxable year as specified in section 316(a)(2), shall be treated (i) as class A capital gain to the extent of the shareholder's pro rata share of the adjusted class A capital gain (computed by the corporation as though it were a taxpayer other than a corporation except that section 1212(b)(2) shall not apply) for such taxable year, and (ii) as class B capital gain to the extent of the shareholder's pro rata share of the adjusted class B capital gain (computed by the corporation as though it were a taxpayer other than a corporation except that section 1212(b)(2) shall not apply) for such taxable year. For purposes of this paragraph, the adjusted class A capital gain or the adjusted class B capital gain shall be deemed not to exceed an amount equal to that portion of the corporation's taxable income (computed as provided in section 1373(d)) for the taxable year which bears the same ratio to such taxable income as such adjusted class A capital gain or such adjusted class B capital gain (determined without regard to the provisions of this sentence) bears to the sum of such adjusted class A and adjusted class B capital gains.

"(2) DETERMINATION OF SHAREHOLDER'S PRO RATA SHARE.—A shareholder's pro rata share of the adjusted class A or adjusted class B capital gain (computed as provided in paragraph (1)) for any taxable year shall be an amount which bears the same ratio to such adjusted class A capital gain or such adjusted class B capital gain as the amount of dividends described in paragraph (1) includible in the shareholder's gross income bears to the entire amount of dividends described in paragraph (1) includible in the gross income of all shareholders."

(d) EFFECTIVE DATE.—

(1) GENERAL RULE.—Except as otherwise specifically provided, and except as provided by paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1963.

## (2) TRANSITION RULES.—

## (A) DISTRIBUTIONS OF CAPITAL GAINS.—

(i) If a taxpayer, other than a corporation, is required to include as capital gain in his gross income for a taxable year beginning after December 31, 1963, an amount attributable to sales or exchanges of capital assets held for more than 6 months and such gain was realized in a taxable year beginning before January 1, 1964, by a person described in clause (iii), such amount shall be treated by such taxpayer as class B capital gain.

(ii) If a taxpayer, other than a corporation, is required to include as capital gain in his gross income for a taxable year beginning before January 1, 1964, an amount attributable to sales or exchanges of capital assets held for more than 6 months and such gain was realized in a taxable year beginning after December 31, 1963, by a person described in clause (iii), such amounts shall be treated by such taxpayer as long-term capital gain.

(iii) This subparagraph applies in respect of a regulated investment company or a real estate investment trust to which subchapter M of chapter 1 of the Internal Revenue Code of 1954 applies, a foreign investment company to which section 1247 of such Code applies, an electing small business corporation to which subchapter S of chapter 1 of such Code applies, a common trust fund to which section 584 applies, a partnership, an estate, and a trust.

(B) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK.—If a shareholder (or a holder of a beneficial interest), other than a corporation, in a regulated investment company, real estate investment trust, or foreign investment company is required for a taxable year beginning before January 1, 1964, under section 852(b)(3)(B) or (D), section 857(b)(3)(B), or section 1247(d), to treat an amount with respect to a share (or beneficial interest), as a long-term capital gain, and such share (or beneficial interest) is held by the taxpayer for less than 31 days (6 months or less in the case of a shareholder of a foreign investment company), then a loss on the sale or exchange of such share in a taxable year of such shareholder beginning after December 31, 1963, shall to the extent of such long-term capital gain, be treated as loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years.

(C) REGULATORY AUTHORITY.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(D) MEANING OF TERMS.—Terms used in this subsection shall have the same meaning as when used in chapter 1 of the Internal Revenue Code of 1954.

**SEC. 220. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.**

(a) GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by adding at the end thereof the following new section:

**“SEC. 1250. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.****“(a) GENERAL RULE.—**

“(1) ORDINARY INCOME.—Except as otherwise provided in this section, if section 1250 property is disposed of after December 31, 1963, the applicable percentage of the lower of—

“(A) the additional depreciation (as defined in subsection (b)(1)) in respect of the property, or

“(B) the excess of—

“(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over

“(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

“(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term ‘applicable percentage’ means 100 percent minus one percentage point for each full month the property was held after the date on which the property was held 20 full months.

"(b) ADDITIONAL DEPRECIATION DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'additional depreciation' means, in the case of any property, the depreciation adjustments in respect of such property; except that, in the case of property held more than one year, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such adjustments had been determined for each taxable year under the straight line method of adjustment. For purposes of the preceding sentence, if a useful life (or salvage value) was used in determining the amount allowed as a deduction for any taxable year, such life (or value) shall be used in determining the depreciation adjustments which would have resulted for such year under the straight line method.

"(2) PROPERTY HELD BY LESSEE.—In the case of a lessee, in determining the depreciation adjustments which would have resulted in respect of any building erected (or other improvement made) on the leased property, or in respect of any cost of acquiring the lease, the lease period shall be treated as including all renewal periods. For purposes of the preceding sentence—

"(A) the term 'renewal period' means any period for which the lease may be renewed, extended, or continued pursuant to an option exercisable by the lessee, but

"(B) the inclusion of renewal periods shall not extend the period taken into account by more than  $\frac{1}{2}$  of the period on the basis of which the depreciation adjustments were allowed.

"(3) DEPRECIATION ADJUSTMENTS.—The term 'depreciation adjustments' means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescence, or amortization (other than amortization under section 168). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed.

"(c) SECTION 1250 PROPERTY.—For purposes of this section, the term 'section 1250 property' means any real property (other than section 1245 property, as defined in section 1245 (a) (3)) which is or has been property of a character subject to the allowance for depreciation provided in section 167.

"(d) EXCEPTIONS AND LIMITATIONS.—

"(1) GIFTS.—Subsection (a) shall not apply to a disposition by gift.

"(2) TRANSFERS AT DEATH.—Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

"(3) CERTAIN TAX-FREE TRANSACTIONS.—If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371 (a), 374 (a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a) (1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

"(4) LIKE KIND EXCHANGES; INVOLUNTARY CONVERSIONS, ETC.—

"(A) RECOGNITION LIMIT.—If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a) (1) shall not exceed the greater of the following:

"(i) the amount of gain recognized on the disposition (determined without regard to this section), increased as provided in subparagraph (B), or

"(ii) the amount determined under subparagraph (C).

"(B) INCREASE FOR CERTAIN STOCK.—With respect to any transaction, the increase provided by this subparagraph is the amount equal to the fair market value of any stock purchased in a corporation which (but for this paragraph) would result in nonrecognition of gain under section 1033 (a) (3) (A).

“(C) ADJUSTMENT WERE INSUFFICIENT SECTION 1250 PROPERTY IS ACQUIRED.—With respect to any transaction, the amount determined under this subparagraph shall be the excess of—

“(i) the amount of gain which would (but for this paragraph be taken into account under subsection (a) (1), over

“(ii) the fair market value (or cost in the case of a transaction described in section 1033(a) (3)) of the section 1250 property acquired in the transaction.

“(D) BASIS OF PROPERTY ACQUIRED.—In the case of property purchased by the taxpayer in a transaction described in section 1033(a) (3), in applying the last sentence of section 1033(c), such sentence shall be applied—

“(i) first solely to section 1250 properties and to the amount of gain not taken into account under subsection (a) (1) by reason of this paragraph, and

“(ii) then to all purchased properties to which such sentence applies and to the remaining gain not recognized on the transaction as if the cost of the section 1250 properties were the basis of such properties computed under clause (i).

In the case of property acquired in any other transaction to which this paragraph applies, rules consistent with the preceding sentence shall be applied under regulations prescribed by the Secretary or his delegate.

“(E) ADDITIONAL DEPRECIATION WITH RESPECT TO PROPERTY DISPOSED OF.—In the case of any transaction described in section 1031 or 1033, the additional depreciation in respect of the section 1250 property acquired which is attributable to the section 1250 property disposed of shall be an amount equal to the amount of the gain which was not taken into account under subsection (a) (1) by reason of the application of this paragraph.

“(5) SECTION 1071 AND 1081 TRANSACTIONS.—Under regulations prescribed by the Secretary or his delegate, rules consistent with paragraphs (3) and (4) of this subsection and with subsections (e) and (f) shall apply in the case of transactions described in section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or section 1081 (relating to exchanges in obedience to SEC orders).

“(6) PROPERTY DISTRIBUTED BY A PARTNERSHIP TO A PARTNER.—

“(A) IN GENERAL.—For purposes of this section, the basis of section 1250 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

“(B) ADDITIONAL DEPRECIATION.—In respect of any property described in subparagraph (A), the additional depreciation attributable to periods before the distribution by the partnership shall be—

“(i) the amount of the gain to which subsection (a) would have applied of such property had been sold by the partnership immediately before the distribution at its fair market value at such time and the applicable percentage for the property had been 100 percent reduced by

“(ii) if section 751(b) applied to any part of such gain, the amount of such gain to which section 751(b) would have applied if the applicable percentage for the property had been 100 percent.

“(7) DISPOSITION OF PRINCIPAL RESIDENCE.—Subsection (a) shall not apply to a disposition of—

“(A) property to the extent used by the taxpayer as his principal residence (within the meaning of section 1034, relating to sale or exchange of residence), and

“(B) property in respect of which the taxpayer meets the age and ownership requirements of section 121 (relating to gains from sale or exchange of residence of individual who has attained the age of 65) but only to the extent that he meets the use requirements of such section in respect of such property.

“(c) HOLDING PERIOD.—For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules:

“(1) BEGINNING OF HOLDING PERIOD.—The holding period of section 1250 property shall be deemed to begin—

"(A) in the case of property acquired by the taxpayer, on the day after the date of acquisition, or

"(B) in the case of property constructed, reconstructed, or erected by the taxpayer, on the first day of the month during which the property is placed in service.

"(2) PROPERTY WITH TRANSFERRED BASIS.—If the basis of property acquired in a transaction described in paragraph (1), (2), (3), or (5) of subsection (d) is determined by reference to its basis in the hands of the transferor, then the holding period of the property in the hands of the transferee shall include the holding period of the property in the hands of the transferor.

"(3) PRINCIPAL RESIDENCE.—If the basis of property acquired in a transaction described in paragraph (7) of subsection (d) is determined by reference to the basis in the hands of the taxpayer of other property, then the holding period of the property acquired shall include the holding period of such other property.

"(f) SPECIAL RULES FOR PROPERTY WHICH IS SUBSTANTIALLY IMPROVED.—

"(1) AMOUNT TREATED AS ORDINARY INCOME.—If, in the case of a disposition described in section 1250 property, the property is treated as consisting of more than one element by reason of paragraph (3), then the amount taken into account under subsection (a) (1) in respect of such section 1250 property as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 shall be the sum of the amounts determined under paragraph (2).

"(2) ORDINARY INCOME ATTRIBUTABLE TO AN ELEMENT.—For purposes of paragraph (1), the amount taken into account for any element shall be the amount determined by multiplying—

"(A) the amount which bears the same ratio to the lower of the amounts specified in subparagraph (A) or (B) of subsection (a) (1) for the section 1250 property as the additional depreciation for such element bears to the sum of the additional depreciation for all elements, by

"(B) the applicable percentage for such element.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property. "

"(3) PROPERTY CONSISTING OF MORE THAN ONE ELEMENT.—In applying this subsection in the case of any section 1250 property, there shall be treated as a separate element—

"(A) each separate improvement,

"(B) if, before completion of section 1250 property, units thereof (as distinguished from improvements) were placed in service, each such unit of section 1250 property, and

"(C) the remaining property which is not taken into account under subparagraphs (A) and (B).

"(4) PROPERTY WHICH IS SUBSTANTIALLY IMPROVED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'separate improvement' means each improvement added during the 36-month period ending on the last day of any taxable year to the capital account for the property, but only if the sum of the amounts added to such account during such period exceeds the greatest of—

"(i) 25 percent of the adjusted basis of the property,

"(ii) 10 percent of the adjusted basis of the property, determined without regard to the adjustments provided in paragraphs (2) and (3) of section 1016(a), or

"(iii) \$5,000.

For purposes of clauses (i) and (ii), the adjusted basis of the property shall be determined as of the beginning of the first day of such 36-month period, or of the holding period of the property (within the meaning of subsection (e)), whichever is the later.

"(B) EXCEPTION.—Improvements in any taxable year shall be taken into account for purposes of subparagraph (A) only if the sum of the amounts added to the capital account for the property for such taxable year exceeds the greater of—

"(1) \$2,000, or

"(ii) one percent of the adjusted basis referred to in subparagraph (A) (ii), determined, however, as of the beginning of such taxable year.

For purposes of this section, if the amount added to the capital account for any separate improvement does not exceed the greater of clause (i) or (ii), such improvement shall be treated as placed in service on the first day, of a calendar month, which is closest to the middle of the taxable year.

"(C) IMPROVEMENT.—The term 'improvement' means, in the case of any section 1250 property, any addition to capital account for such property after the initial acquisition or after completion of the property.

"(g) ADJUSTMENTS TO BASIS.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

"(h) APPLICATION OF SECTION.—This section shall apply notwithstanding any other provision of this subtitle."

(b) TECHNICAL AMENDMENTS.—

(1) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS.—

(A) The heading of section 170(e) (relating to special rule for charitable contributions of section 1245 property) is amended by striking out "SECTION 1245 PROPERTY" and inserting in lieu thereof "CERTAIN PROPERTY".

(B) The text of such section 170(e) is amended by striking out "section 1245(a)" and inserting in lieu thereof "section 1245(a) or 1250(a)".

(2) CORPORATE DISTRIBUTIONS OF PROPERTY.—Subsections (b) and (d) of section 301 (relating to amount distributed) are each amended by striking out "under section 1245(a)" and inserting in lieu thereof "under section 1245(a) or 1250(a)".

(3) EFFECT ON EARNINGS AND PROFITS.—Paragraph (3) of section 312(c) (relating to adjustments of earnings and profits) is amended by striking out "or under section 1245(a)" and inserting in lieu thereof "or under section 1245(a) or 1250(a)".

(4) COLLAPSIBLE CORPORATIONS.—Paragraph (12) of section 341(e) (relating to collapsible corporations) is amended by striking out "section 1245(a)" and inserting in lieu thereof "sections 1245(a) and 1250(a)".

(5) INSTALLMENT OBLIGATIONS IN CERTAIN LIQUIDATIONS.—Subparagraphs (A) and (B) of section 453(d) (4) (relating to distribution of installment obligations in certain corporate liquidations) are each amended by striking out "section 1245(a)" and inserting in lieu thereof "section 1245(a) or 1250(a)".

(6) SPECIAL RULE FOR PARTNERSHIPS.—Section 751(c) (relating to definition of "unrealized receivables" for purposes of subchapter K) is amended by striking out "(as defined in section 1245(a) (3))" and inserting in lieu thereof "(as defined in section 1245(a) (3) and section 1250 property (as defined in section 1250(c))" and by striking out "to which section 1245(a)" and inserting in lieu thereof "to which section 1245(a) or 1250(a)".

(7) The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end thereof the following:

"Sec. 1250. Gain from dispositions of certain depreciable realty."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 1963, in taxable years ending after such date.

#### SEC. 221. AVERAGING.

(a) GENERAL RULE.—Part I of subchapter Q of chapter 1 is amended to read as follows:

##### "PART I—INCOME AVERAGING

"Sec. 1301. Limitation on tax.

"Sec. 1302. Definition of averagable income; related definitions.

"Sec. 1303. Eligible individuals.

"Sec. 1304. Special rules.

"Sec. 1305. Regulations.

#### "SEC. 1301. LIMITATION ON TAX.

"If an eligible individual has averagable income for the computation year, and if the amount of such income exceeds \$3,000, then the tax imposed by section 1 for the computation year which is attributable to averagable income shall be 5



times the increase in tax under such section which would result from adding 20 percent of such income to the sum of—

“(1) 133 $\frac{1}{3}$  percent of average base period income, and

“(2) the amount (if any) of the average base period capital gain net income.

**“SEC. 1302. DEFINITION OF AVERAGABLE INCOME; RELATED DEFINITIONS.**

“(a) **AVERAGABLE INCOME.**—For purposes of this part—

“(1) **IN GENERAL.**—The term ‘averagable income’ means the amount (if any) by which adjusted taxable income exceeds 133 $\frac{1}{3}$  percent of average base period income.

“(2) **ADJUSTMENT IN CERTAIN CASES FOR CAPITAL GAINS.**—If—

“(A) the average base period capital gain net income, exceeds

“(B) the capital gain net income for the computation year, then the term ‘averagable income’ means the amount determined under paragraph (1), reduced by an amount equal to such excess.

“(b) **ADJUSTABLE TAXABLE INCOME.**—For purposes of this part, the term ‘adjusted taxable income’ means the taxable income for the computation year, decreased by the sum of the following amounts:

“(1) **CAPITAL GAIN NET INCOME FOR THE COMPUTATION YEAR.**—The amount (if any) of the capital gain net income for the computation year.

“(2) **INCOME ATTRIBUTABLE TO GIFTS, BEQUESTS, ETC.**—

“(A) **IN GENERAL.**—The amount of net income attributable to an interest in property where such interest was received by the taxpayer as a gift, bequest, devise, or inheritance during the computation year or any base period year. This paragraph shall not apply to gifts, bequests, devises, or inheritances between husband and wife if they make a joint return, or if one of them makes a return as a surviving spouse (as defined in section 2(b), for the computation year.

“(B) **AMOUNT OF NET INCOME.**—Unless the taxpayer otherwise establishes to the satisfaction of the Secretary or his delegate, the amount of net income for any taxable year attributable to an interest described in subparagraph (A) shall be deemed to be 6 percent of the fair market value of such interest (as determined in accordance with the provisions of chapter 11 or chapter 12, as the case may be).

“(C) **LIMITATION.**—This paragraph shall apply only if the sum of the net incomes attributable to interests described in subparagraph (A) exceeds \$3,000.

“(D) **NET INCOME.**—For purposes of this paragraph, the term ‘net income’ means, with respect to any interest, the excess of—

“(i) items of gross income attributable to such interest, over

“(ii) the deductions properly allocable to or chargeable against such items.

For purposes of computing such net income, capital gains and losses shall not be taken into account.

“(3) **WAGERING INCOME.**—The amount (if any) by which the gains from wagering transactions for the computation year exceed the losses from such transactions.

“(4) **CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.**—The amount (if any) to which section 72(m) (5) (relating to penalties applicable to certain amounts received by owner-employees) applies.

“(c) **AVERAGE BASE PERIOD INCOME.**—For purposes of this part—

“(1) **IN GENERAL.**—The term ‘average base period income’ means one-fourth of the sum of the base period incomes for the base period.

“(2) **BASE PERIOD INCOME.**—The base period income for any taxable year is the taxable income for such year first increased and then decreased (but not below zero) in the following order:

“(A) Taxable income shall be increased by an amount equal to the excess of—

“(1) the amount excluded from gross income under section 911 (relating to earned income from sources without the United States) and subpart D of part III of subchapter N (sec. 931 and following, relating to income from sources within possessions of the United States), over

“(ii) the deductions which would have been properly allocable to or chargeable against such amount but for the exclusion of such amount from gross income.

"(B) Taxable income shall be decreased by the capital gain net income.

"(C) If the decrease provided by paragraph (2) of subsection (b) applies to the computation year, the taxable income shall be decreased under the rules of such paragraph (2) (other than the limitation contained in subparagraph (C) thereof).

"(d) CAPITAL GAIN NET INCOME, ETC.—For purposes of this part—

"(1) CAPITAL GAIN NET INCOME.—The term 'capital gain net income' means, for any taxable year beginning after December 31, 1963, the amount (if any) by which—

"(A) the sum of the adjusted class A capital gain and the adjusted class B capital gain, exceeds

"(B) the deduction allowable under section 1202(a).

The term 'capital gain net income' means, for any taxable year beginning before January 1, 1964, the amount equal to 50 percent of the excess of the net long-term capital gain over the net short-term capital loss.

"(2) AVERAGE BASE PERIOD CAPITAL GAIN NET INCOME.—The term 'average base period capital gain net income' means one-fourth of the sum of the capital gain net incomes for the base period. For purposes of the preceding sentence, the capital gain net income for any base period year shall not exceed the base period income for such year computed without regard to subsection (c) (2) (B).

"(e) OTHER RELATED DEFINITIONS.—For purposes of this part—

"(1) COMPUTATION YEAR.—The term 'computation year' means the taxable year for which the taxpayer chooses the benefits of this part.

"(2) BASE PERIOD.—The term 'base period' means the 4 taxable years immediately preceding the computation year.

"(3) BASE PERIOD YEAR.—The term 'base period year' means any of the 4 taxable years immediately preceding the computation year.

"(4) JOINT RETURN.—The term 'joint return' means the return of a husband and wife made under section 6013.

#### "SEC. 1303. ELIGIBLE INDIVIDUALS.

"(a) GENERAL RULE.—Except as otherwise provided in this section, for purposes of this part the term 'eligible individual' means any individual who is a citizen or resident of the United States throughout the computation year.

"(b) NONRESIDENT ALIEN INDIVIDUALS.—For purposes of this part, an individual shall not be an eligible individual for the computation year if, at any time during such year or the base period, such individual was a nonresident alien.

"(c) INDIVIDUALS RECEIVING SUPPORT FROM OTHERS.—

"(1) IN GENERAL.—For purposes of this part, an individual shall not be an eligible individual for the computation year if, for any base period year, such individual (and his spouse) furnished less than one-half of his support.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any computation year if—

"(A) such year ends after the individual attained age 25 and, during at least 4 of his taxable years beginning after he attained age 21 and ending with his computation year, he was not a full-time student.

"(B) more than one-half of the individual's adjusted taxable income for the computation year is attributable to work performed by him in substantial part during 2 or more of the base period years, or

"(C) the individual makes a joint return for the computation year and not more than 25 percent of the aggregate adjusted gross income of such individual and his spouse for the computation year is attributable to such individual.

In applying subparagraph (C), amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income shall be taken into account as if such amounts did not constitute community income.

"(d) STUDENT DEFINED.—For purposes of this section, the term 'student' means, with respect to a taxable year, an individual who during each of 5 calendar months during such taxable year—

"(1) was a full-time student at an educational institution (as defined in section 151(e)(4)) ; or

"(2) was pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution (as defined in section 151(e)(4)) or of a State or political subdivision of a State.

**"SEC. 1304. SPECIAL RULES.**

"(a) **TAXPAYER MUST CHOOSE BENEFITS.**—This part shall apply to the taxable year only if the taxpayer chooses to have the benefits of this part for such taxable year. Such choice may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for the taxable year.

"(b) **CERTAIN PROVISIONS INAPPLICABLE.**—If the taxpayer chooses the benefits of this part for the taxable year, the following provisions shall not apply to him for such year:

"(1) section 3 (relating to optional tax if adjusted gross income is less than \$5,000),

"(2) section 72(n)(2) (relating to limitation of tax in case of certain distributions with respect to contributions by self-employed individuals),

"(3) section 911 (relating to earned income from sources without the United States), and

"(4) subpart D of part III of subchapter N (sec. 931 and following, relating to income from sources within possessions of the United States).

"(c) **FAILURE OF CERTAIN MARRIED INDIVIDUALS TO MAKE JOINT RETURN, ETC.**—

"(1) **APPLICATION OF SUBSECTION.**—Paragraphs (2), (3), and (4) of this subsection shall apply in the case of any individual who was married for any base period or the computation year; except that—

(A) such paragraphs shall not apply in respect of a base period year if—

"(i) such individual and his spouse make a joint return, or such individual makes a return as a surviving spouse (as defined in section 2(b)), for the computation year, and

"(ii) such individual was not married to any other spouse for such base period year, and

"(B) paragraph (4) shall not apply in respect of the computation year if the individual and his spouse make a joint return for such year.

"(2) **MINIMUM BASE PERIOD INCOME.**—For purposes of this part, the base period income of an individual for any base period year shall not be less than 50 percent of the base period income which would result from combining his income and deductions for such year—

"(A) with the income and deductions for such year of the individual who is his spouse for the computation year, or

"(B) if greater, with the income and deductions for such year of the individual who was his spouse for such base period year.

"(3) **MINIMUM BASE PERIOD CAPITAL GAIN NET INCOME.**—For purposes of this part, the capital gain net income of any individual for any base period year shall not be less than 50 percent of the capital gain net income which would result from combining his capital gain net income for such year (determined without regard to this paragraph) with the capital gain net income for such year (similarly determined) of the individual with whom he is required by paragraph (2) to combine his income and deductions for such year.

"(4) **COMMUNITY INCOME ATTRIBUTABLE TO SERVICES.**—In the case of amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income—

"(A) the amount taken into account for any base period year for purposes of determining base period income shall not be less than the amount which would be taken into account if such amounts did not constitute community income, and

"(B) the amount taken into account for purposes of determining adjusted taxable income for the computation year shall not exceed the amount which would be taken into account if such amounts did not constitute community income.

"(5) **MARITAL STATUS.**—For purposes of this subsection, section 143 shall apply in determining whether an individual is married for any taxable year.

"(d) **DOLLAR LIMITATIONS IN CASE OF JOINT RETURNS.**—In the case of a joint return, the \$3,000 figure contained in section 1301 shall be applied to the aggre-

gate averagable income, and the \$3,000 figure contained in section 1302(b) (2) (C) shall be applied to the aggregate net incomes.

**"(e) SPECIAL RULES WHERE THERE ARE CAPITAL GAINS.—**

**"(1) TREATMENT OF CAPITAL GAINS IN COMPUTATION YEAR.—**In the case of any taxpayer who has capital gain net income for the computation year, the tax imposed by section 1 for the computation year which is attributable to the amount of such net income shall be computed—

**"(A)** by adding so much of the amount thereof as does not exceed average period capital gain net income above 133 $\frac{1}{2}$  percent of average base period income, and

**"(B)** by adding the remainder (if any) of such net income above the 20 percent of the averagable income as taken into account for purposes of computing the tax imposed by section 1 (and above the amounts (if any) referred to in subsection (f) (1)).

**"(2) COMPUTATION OF ALTERNATIVE TAX.—**In the case of any taxpayer who has capital gain net income for the computation year, section 1201(b) shall be treated as imposing a tax equal to the tax imposed by section 1, reduced by the amount (if any) by which—

**"(A)** the tax imposed by section 1 and attributable to the capital gain net income for the computation year (determined under paragraph (1)), exceeds

**"(B)** the sum of—

**"(i)** 21 percent of the adjusted class A capital gain, and

**"(ii)** 25 percent of the adjusted class B capital gain.

**"(f) TREATMENT OF CERTAIN OTHER ITEMS.—**

**"(1) GIFT OR WAGERING INCOME.—**The tax imposed by section 1 for the computation year which is attributable to the amounts subtracted from taxable income under paragraphs (2) and (3) of section 1302(b) shall equal the increase in tax under section 1 which results from adding such amounts above the 20 percent of the averagable income as taken into account for purposes of computing the tax imposed thereon by section 1.

**"(2) SECTION 72(m) (5).—**Section 72(m) (5) (relating to penalties applicable to certain amounts received by owner-employees) shall be applied as if this part had not been enacted.

**"(3) OTHER ITEMS.—**Except as otherwise provided in this part, the order and manner in which items of income shall be taken into account in computing the tax imposed by this chapter on the income of any eligible individual to whom section 1301 applies for any computation year shall be determined under regulations prescribed by the Secretary or his delegate.

**"(g) SHORT TAXABLE YEARS.—**In the case of any computation year or base period year which is a short taxable year, this part shall be applied in the manner provided in regulations prescribed by the Secretary or his delegate.

**"SEC. 1305. REGULATIONS.**

"The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this part."

**(b) REPEAL OF SECTION 72(e) (3).—**Section 72(e) (3) (relating to limit on tax attributable to receipt of lump sum) is hereby repealed.

**(c) STATUTE OF LIMITATIONS.—**Section 6511(d) (2) (B) (relating to special period of limitation with respect to net operating loss carrybacks) is amended to read as follows:

**"(B) APPLICABLE RULES.—**

**"(1)** If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback is otherwise prevented by the operation of any law or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law other than section 7122, such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a). In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any pro-

ceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, to the extent that such deduction is affected by a carryback which was not in issue in such proceeding.

"(ii) A claim for credit or refund for a computation year (as defined in section 1302(e)(1)) shall be determined to relate to an overpayment attributable to a net operating loss carryback when such carryback relates to any base period year (as defined in section 1302(e)(3))."

(d) **TECHNICAL AMENDMENTS.**—The following provisions are amended by striking out "except that section 72(e)(3) shall not apply":

(1) The first sentence of section 402(a)(1) (relating to general rule for taxability of beneficiary of exempt trust).

(2) The second sentence of section 402(b) (relating to taxability of beneficiary of non-exempt trust).

(3) The second sentence of section 402(d) (relating to certain employees' annuities).

(4) Section 403(a)(1) (relating to the general rule for taxability of a beneficiary under a qualified annuity plan).

(5) The second sentence of section 403(b)(1) (relating to general rule for taxability of beneficiary, etc.).

(6) The second sentence of section 403(c) (relating to taxability of beneficiary under a nonqualified annuity).

(e) **CLERICAL AMENDMENTS.**—

(1) Subsection (f) of section 4 (relating to cross references to rules for optional tax) is amended by adding at the end thereof the following new paragraph:

"(3) For rule that optional tax is not to apply if individual chooses the benefits of income averaging, see section 1304(b)."

(2) Subsection (b) of section 5 (relating to cross references to special limitations on tax) is amended to read as follows:

"(b) **SPECIAL LIMITATIONS ON TAX.**—

"(1) For limitation on surtax attributable to sales of oil or gas properties, see section 632.

"(2) For limitation on tax in case of income of members of Armed Forces on death, see section 692.

"(3) For limitation on tax where an individual chooses the benefits of income averaging, see section 1301.

"(4) For computation of tax where taxpayer restores substantial amount held under claim of right, see section 1341.

"(5) For limitation on surtax attributable to claims against the United States involving acquisitions of property, see section 1347."

(3) The table of parts for subchapter Q of chapter 1 is amended by striking out

"Part I. Income attributable to several taxable years."

and inserting in lieu thereof

"Part I. Income averaging."

(f) **EFFECTIVE DATE.**—

(1) **GENERAL RULE.**—Except as provided in paragraph (2), the amendments made by this section shall apply with respect to taxable years beginning after December 31, 1963.

(2) **INCOME FROM AN EMPLOYMENT.**—If, in a taxable year beginning after December 31, 1963, an individual or partnership receives or accrues compensation from an employment (as defined by section 1301(b) of the Internal Revenue Code of 1954 as in effect immediately before the enactment of this Act) and the employment began before February 6, 1963, the tax attributable to such compensation may, at the election of the taxpayer, be computed under the provisions of sections 1301 and 1307 of such Code as in effect immediately before the enactment of this Act. If a taxpayer so elects (at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes), he may not choose for such taxable year the benefits provided by part I of subchapter Q of chapter 1 of such Code (relating to income averaging) as amended by this Act.

**SEC. 222. REPEAL OF ADDITIONAL 2-PERCENT TAX FOR CORPORATIONS FILING CONSOLIDATED RETURNS.**

(a) **REPEAL OF TAX.**—Subsection (a) of section 1503 (relating to computation and payment of tax in case of consolidated returns) is amended to read as follows:

“(a) **GENERAL RULE.**—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of such return.”

(b) **TECHNICAL AND CONFORMING AMENDMENTS.**—

(1) Section 1503 is amended by striking out subsections (b) and (c) and by relettering subsection (d) as subsection (b).

(2) Paragraph (3) of section 1503(b) (as relettered by paragraph 1) is amended to read as follows:

“(3) **SPECIAL RULES.**—

“(A) For purposes of paragraph (2), a corporation is a regulated public utility only if it is a regulated public utility within the meaning of subparagraph (A) (other than clauses (ii) and (iii) thereof) or (D) of section 7701(a)(33). For purposes of the preceding sentence, the limitation contained in the last two sentences of section 7701(a)(33) shall be applied as if subparagraphs (A) through (F), inclusive, of section 7701(a)(33) were limited to subparagraphs (A)(i) and (D) thereof.

“(B) For purposes of paragraph (2), the foreign countries referred to in this subparagraph include only any country from which any public utility referred to in the first sentence of paragraph (2) derives the principal part of its income.

“(C) For purposes of this subsection, the term ‘consolidated taxable income’ means the consolidated taxable income computed without regard to the deduction provided by section 242 for partially tax-exempt interest.”

(3) Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

“(33) **REGULATED PUBLIC UTILITY.**—The term ‘regulated public utility’ means—

“(A) A corporation engaged in the furnishing or sale of—

“(i) electric energy, gas, water, or sewerage disposal services,  
or

“(ii) transportation (not included in subparagraph (C)) on an intrastate, suburban, municipal, or interurban electric railroad, on an intrastate, municipal, or suburban trackless trolley system, or on a municipal or suburban bus system, or

“(iii) transportation (not included in clause (ii)) by motor vehicle—

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, by a public service or public utility commission or other similar body of the District of Columbia or of any State or political subdivision thereof, or by a foreign country or an agency or instrumentality or political subdivision thereof.

“(B) A corporation engaged as a common carrier in the furnishing or sale of transportation of gas by pipeline, if subject to the jurisdiction of the Federal Power Commission.

“(C) A corporation engaged as a common carrier (i) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Interstate Commerce Commission, or (ii) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipe line, if subject to the jurisdiction of the Interstate Commerce Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State.

“(D) A corporation engaged in the furnishing or sale of telephone or telegraph service, if the rates for such furnishing or sale meet the requirements of subparagraph (A);

“(E) A corporation engaged in the furnishing or sale of transportation as a common carrier by air, subject to the jurisdiction of the Civil Aeronautics Board.

“(F) A corporation engaged in the furnishing or sale of transportation by common carrier by water, subject to the jurisdiction of the Interstate Commerce Commission under part III of the Interstate Commerce Act, or subject to the jurisdiction of the Federal Maritime Board under the Intercoastal Shipping Act, 1933.

“(G) A railroad corporation subject to part I, of the Interstate Commerce Act, if (i) substantially all of its railroad properties have been leased to another such railroad corporation or corporations by an agreement or agreements entered into before January 1, 1954, (ii) each lease is for a term of more than 20 years, and (iii) at least 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from such leases and from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, an agreement for lease of railroad properties entered into before January 1, 1954, shall be considered to be a lease including such term as the total number of years of such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into before January 1, 1954.

“(H) A common parent corporation which is a common carrier by railroad subject to part I of the Interstate Commerce Act if at least 80 percent of its gross income (computed without regard to capital gains or losses) is derived directly or indirectly from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, dividends and interest, and income from leases described in subparagraph (G), received from a regulated public utility shall be considered as derived from sources described in subparagraphs (A) through (F), inclusive, if the regulated public utility is a member of an affiliated group (as defined in section 1504) which includes the common parent corporation.

The term ‘regulated public utility’ does not (except as provided in subparagraphs (G) and (H)) include a corporation described in subparagraphs (A) through (F), inclusive, unless 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from sources described in subparagraphs (A) through (F), inclusive. If the taxpayer establishes to the satisfaction of the Secretary or his delegate that (i) its revenue from regulated rates described in subparagraph (A) or (D) and its revenue derived from unregulated rates are derived from the operation of a single interconnected and coordinated system or from the operation of more than one such system, and (ii) the unregulated rates have been and are substantially as favorable to users and consumers as are the regulated rates, then such revenue from such unregulated rates shall be considered, for purposes of the preceding sentence, as income derived from sources described in subparagraph (A) or (D).”

(4) Section 12(8) (relating to cross reference to additional tax for corporations filing consolidated returns) is hereby repealed.

(5) Paragraphs (1) and (2) of section 172(j) (relating to carryover of net operating loss for certain regulated transportation corporations) are amended to read as follows:

“(1) DEFINITION.—For purposes of subsection (b) (1) (C), the term ‘regulated transportation corporation’ means a corporation—

“(A) 80 percent or more of the gross income of which (computed without regard to dividends and capital gains and losses) for the taxable year is derived from the furnishing or sale of transportation described in subparagraph (A), (C) (i), (E), or (F) of section 7701(a) (33) and taken into account for purposes of the limitation contained in the last two sentences of section 7701(a) (33),

“(B) which is described in subparagraph (G) or (H) of section 7701(a) (33), or

“(C) which is a member of a regulated transportation system.

"(2) REGULATED TRANSPORTATION SYSTEM.—For purposes of this subsection, a corporation shall be treated as a member of a regulated transportation system for a taxable year if—

"(A) it is a member of an affiliated group of corporations making a consolidated return for such taxable year, and

"(B) 80 percent or more of the aggregate gross income of the members of such affiliated group (computed without regard to dividends and capital gains and losses) for such taxable year is derived from sources described in paragraph (1) (A).

For purpose of subparagraph (B), income derived by a corporation described in subparagraph (G) or (H) of section 7701(a)(33) from leases described in subparagraph (G) thereof shall be considered as derived from sources described in paragraph (1) (A)."

(6) Section 904(g)(2) (relating to cross references for purposes of the limitation on the foreign tax credit) is amended by striking out "section 1503(d)" and inserting in lieu thereof "section 1503(b)".

(7) Section 1341(b)(2) (relating to special rules for the computation of tax where taxpayer restores substantial amount held under claim of right) is amended by striking out "(as defined in section 1503(c) without regard to paragraph (2) thereof)" and inserting in lieu thereof "as defined in section 7701(a)(33) without regard to the limitation contained in the last two sentences thereof".

(8) Section 1552 (a) (3) (relating to the allocation of tax liability among members of an affiliated group of corporations filing consolidated returns) is amended by striking out "(determined without regard to the 2 percent increase provided by section 1503(a))".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1963.

#### SEC. 223. REDUCTION OF SURTAX EXEMPTION IN CASE OF CERTAIN CONTROLLED CORPORATIONS, ETC.

(a) IN GENERAL.—Subchapter B of chapter 6 (related rules for consolidated returns) is amended by adding at the end thereof the following new part:

##### "PART II—CERTAIN CONTROLLED CORPORATIONS

"Sec. 1501. Surtax exemptions in case of certain controlled corporations.

"Sec. 1562. Privilege of groups to elect multiple surtax exemptions.

"Sec. 1563. Definitions and special rules.

#### "SEC. 1551. SURTAX EXEMPTIONS IN CASE OF CERTAIN CONTROLLED CORPORATIONS.

"(a) GENERAL RULE.—If a corporation is a component member of a controlled group of corporations on a December 31, then for purposes of this subtitle the surtax exemption of such corporation for the taxable year which includes such December 31 shall be an amount equal to—

"(1) \$25,000 divided by the number of corporations which are component members of such group on such December 31, or

"(2) if all such component members consent (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe) to an apportionment plan, such portion of \$25,000 as is apportioned to such member in accordance with such plan.

The sum of the amounts apportioned under paragraph (2) among the component members of any controlled group shall not exceed \$25,000.

"(b) CERTAIN SHORT TAXABLE YEARS.—If a corporation—

"(1) has a short taxable year which does not include a December 31, and

"(2) is a component member of a controlled group of corporations with respect to such taxable year,

then for purposes of this subtitle the surtax exemption of such corporation for such taxable year shall be an amount equal to \$25,000 divided by the number of corporations which are component members of such group on the last day of such taxable year. For purposes of the preceding sentence, section 1563(b) shall be applied as if such last day were substituted for December 31.

#### "SEC. 1562. PRIVILEGE OF GROUPS TO ELECT MULTIPLE SURTAX EXEMPTIONS.

"(a) ELECTION OF MULTIPLE SURTAX EXEMPTIONS.—

"(1) IN GENERAL.—A controlled group of corporations shall (subject to the provisions of this section) have the privilege of electing to have each of



its component members make its returns without regard to section 1561. Such election shall be made with respect to a specified December 31 and shall be valid only if—

“(A) each corporation which is a component member of such group on such December 31, and

“(B) each other corporation which is a component member of such group on any succeeding December 31 before the day on which the election is filed,

consents to such election.

“(2) YEARS FOR WHICH EFFECTIVE.—An election by a controlled group of corporations under paragraph (1) shall be effective with respect to the taxable year of each component member of such group which includes the specified December 31, and each taxable year of each corporation which is a component member of such group (or a successor group) on a succeeding December 31 included within such taxable year, unless the election is terminated under subsection (c).

“(3) EFFECT OF ELECTION.—If an election by a controlled group of corporations under paragraph (1) is effective with respect to any taxable year of a corporation—

“(A) section 1561 shall not apply to such corporation for such taxable year, but

“(B) the additional tax imposed by subsection (b) shall apply to such corporation for such taxable year.

“(b) ADDITIONAL TAX IMPOSED.—

“(1) GENERAL RULE.—If an election under subsection (a) (1) by a controlled group of corporations is effective with respect to the taxable year of a corporation, there is hereby imposed for such taxable year on the taxable income of such corporation a tax equal to 6 percent of so much of such corporation's taxable income for such taxable year as does not exceed \$25,000. This paragraph shall not apply to the taxable year of a corporation if no other corporation which is a component member of such controlled group on the December 31 included in such corporation's taxable year has taxable income for its taxable year including such December 31.

“(2) TAX TREATED AS IMPOSED BY SECTION 11, ETC.—If for the taxable year of a corporation a tax is imposed by section 11 on the taxable income of such corporation, the additional tax imposed by this subsection shall be treated for purposes of this title as a tax imposed by section 11. If for the taxable year of a corporation a tax is imposed on the taxable income of such corporation which is computed under any other section by reference to section 11, the additional tax imposed by this subsection shall be treated for purposes of this title as imposed by such other section.

“(3) TAXABLE INCOME DEFINED.—For purposes of this subsection, the term ‘taxable income’ means—

“(A) in the case of a corporation subject to tax under section 511, its unrelated business taxable income (within the meaning of section 512);

“(B) in the case of a life insurance company, its life insurance company taxable income (within the meaning of section 802(b));

“(C) in the case of a regulated investment company, its investment company taxable income (within the meaning of section 852(b)(2)); and

“(D) in the case of a real estate investment trust, its real estate investment trust taxable income (within the meaning of section 857(b)(2)).

“(4) SPECIAL RULES.—If for the taxable year an additional tax is imposed on the taxable income of a corporation by this subsection, then sections 244 (relating to dividends received on certain preferred stock), 247 (relating to dividends paid on certain preferred stock of public utilities), 804 (a) (3) (relating to deduction for partially tax-exempt interest in the case of a life insurance company), and 922 (relating to special deduction for Western Hemisphere trade corporations) shall be applied without regard to the additional tax imposed by this subsection.

“(c) TERMINATION OF ELECTION.—An election by a controlled group of corporations under subsection (a) shall terminate with respect to such group—

“(1) CONSENT OF THE MEMBERS.—If such group files a termination of such election with respect to a specified December 31, and—

"(A) each corporation which is a component member of such group on such December 31, and

"(B) each other corporation which is a component member of such group on any succeeding December 31 before the day on which the termination is filed,

consents to such termination.

"(2) REFUSAL BY NEW MEMBER TO CONSENT.—If on December 31 of any year such group includes a component member which—

"(A) on the immediately preceding January 1 was not a member of such group, and

"(B) within the time and in the manner provided by regulations prescribed by the Secretary or his delegate, files a statement that it does not consent to the election.

"(3) CONSOLIDATED RETURNS.—If—

"(A) a corporation is a component member (determined without regard to section 1563(b)(3)) of such group on a December 31 included within a taxable year ending on or after January 1, 1964, and

"(B) such corporation is a member of an affiliated group of corporations which makes a consolidated return under this chapter (sec. 1501 and following) for such taxable year.

"(4) CONTROLLED GROUP NO LONGER IN EXISTENCE.—If such group is considered as no longer in existence with respect to any December 31.

Such termination shall be effective with respect to the December 31 referred to in paragraph (1) (A), (2), (3), or (4), as the case may be.

"(d) ELECTION AFTER TERMINATION.—If an election by a controlled group of corporations is terminated under subsection (c), such group (and any successor group) shall not be eligible to make an election under subsection (a) with respect to any December 31 before the sixth December 31 after the December 31 with respect to which such termination was effective.

"(e) MANNER AND TIME OF GIVING CONSENT AND MAKING ELECTION, ETC.—An election under subsection (a) (1) or a termination under subsection (c) (1) (and the consent of each member of a controlled group of corporations which is required with respect to such election or termination) shall be made in such manner as the Secretary or his delegate shall by regulations prescribe, and shall be made at any time before the expiration of 3 years after—

"(1) in the case of such an election, the date when the income tax return for the taxable year of the component member of the controlled group which has the taxable year ending first on or after the specified December 31, is required to be filed (without regard to any extensions of time), and

"(2) in the case of such a termination, the specified December 31 with respect to which such termination was made.

Any consent to such an election or termination, and a failure by a component member to file a statement that it does not consent to an election under this section, shall be deemed to be a consent to the application of subsection (g) (1) (relating to tolling of statute of limitations on assessment of deficiencies).

"(f) SPECIAL RULES.—For purposes of this section—

"(1) CONTINUING AND SUCCESSOR CONTROLLED GROUPS.—The determination of whether a controlled group of corporations—

"(A) is considered as no longer in existence with respect to any December 31, or

"(B) is a successor to another controlled group of corporations (and the effect of such determination with respect to any election or termination),

shall be made under regulations prescribed by the Secretary or his delegate. For purposes of subparagraph (B), such regulations shall be based on the continuation (or termination) of predominant equitable ownership.

"(2) CERTAIN SHORT TAXABLE YEARS.—If one or more corporations have short taxable years which do not include a December 31 and are component members of a controlled group of corporations with respect to such taxable years (determined by applying section 1563(b) as if the last day of each such taxable year were substituted for December 31), then an election by such group under this section shall apply with respect to such corporations with respect to such taxable years if—

"(A) such election is in effect with respect to both the December 31 immediately preceding such taxable years and the December 31 immediately succeeding such taxable years, or

"(B) such election is in effect with respect to the December 31 immediately preceding or succeeding such taxable years and each such corporation files a consent to the application of such election to its short taxable year at such time and in such manner as the Secretary or his delegate shall prescribe by regulations.

"(g) TOLLING OF STATUTE OF LIMITATIONS.—In any case in which a controlled group of corporations makes an election or termination under this section—

"(1) the statutory period for assessment of any deficiency against a corporation which is a component member of such group for any taxable year, to the extent such deficiency is attributable to the application of this part, shall not expire before the expiration of one year after the date such election or termination is made; and

"(2) if credit or refund of any overpayment of tax by a corporation which is a component member of such group for any taxable year is prevented, at any time on or before the expiration of one year after the date such election or termination is made, by the operation of any law or rule of law, credit or refund of such overpayment may, nevertheless, be allowed or made, to the extent such overpayment is attributable to the application of this part, if claim therefor is filed on or before the expiration of such one-year period.

**"SEC. 1563. DEFINITIONS AND SPECIAL RULES.**

"(a) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this part, the term 'controlled group of corporations' means any group of—

"(1) PARENT-SUBSIDIARY CONTROLLED GROUP.—One or more chains of corporations connected through stock ownership with a common parent corporation if—

"(A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d) (1)) by one or more of the other corporations; and

"(B) the common parent corporation owns (within the meaning of subsection (d) (1)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding in computing such voting power or value, stock owned directly by such other corporations.

"(2) BROTHER-SISTER CONTROLLED GROUP.—Two or more corporations if stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations is owned (within the meaning of subsection (d) (2)) by one person who is an individual, estate, or trust.

"(3) COMBINED GROUP.—Three or more corporations each of which is a member of a group of corporations described in paragraph (1) or (2), and one of which—

"(A) is a common parent corporation included in a group of corporations described in paragraph (1), and also

"(B) is included in a group of corporations described in paragraph (2).

"(4) CERTAIN INSURANCE COMPANIES.—Two or more insurance companies subject to taxation under section 802 which are members of a controlled group of corporations described in paragraph (1), (2), or (3). Such insurance companies shall be treated as a controlled group of corporations separate from any other corporations which are members of the controlled group of corporations described in paragraph (1), (2), or (3).

"(b) COMPONENT MEMBER.—

"(1) GENERAL RULE.—For purposes of this part, a corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if such corporation—

"(A) is a member of such controlled group of corporations on the December 31 included in such year and is not treated as an excluded member under paragraph (2), or

"(B) is not a member of such controlled group of corporations on the December 31 included in such year but is treated as an additional member under paragraph (3).

"(2) EXCLUDED MEMBERS.—A corporation which is a member of a controlled group of corporations on December 31 of any taxable year shall be treated as an excluded member of such group for the taxable year including such December 31 if such corporation—

"(A) is a member of such group for less than one-half the number of days in such taxable year which precede such December 31,

"(B) is exempt from taxation under section 501(a) (except a corporation which is subject to tax on its unrelated business taxable income under section 511) for such taxable year,

"(C) is a foreign corporation subject to tax under section 881 for such taxable year.

"(D) is an insurance company subject to taxation under section 802 or section 821 (other than an insurance company which is a member of a controlled group described in subsection (a) (4)), or

"(E) is a franchised corporation, as defined in subsection (f) (4).

"(3) ADDITIONAL MEMBERS.—A corporation which—

"(A) was a member of a controlled group of corporations at any time during a calendar year,

"(B) is not a member of such group on December 31 of such calendar year, and

"(C) is not described, with respect to such group, in subparagraph (B), (C), (D), or (E) of paragraph (2),

shall be treated as an additional member of such group on December 31 for its taxable year including such December 31 if it was a member of such group for one-half (or more) of the number of days in such taxable year which precede such December 31.

"(4) OVERLAPPING GROUPS.—If a corporation is a component member of more than one controlled group of corporations with respect to any taxable year, such corporation shall be treated as a component member of only one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary or his delegate which are consistent with the purposes of this part.

"(c) CERTAIN STOCK EXCLUDED.—

"(1) GENERAL RULE.—For purposes of this part, the term 'stock' does not include—

"(A) non-voting stock which is limited and preferred as to dividends,

"(B) treasury stock, and

"(C) stock which is treated as 'excluded stock,' under paragraph (2).

"(2) STOCK TREATED AS 'EXCLUDED STOCK'.—

"(A) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subsection (a) (1), if a corporation (referred to in this paragraph as 'parent corporation') owns (within the meaning of subsections (d) (1) and (e) (4)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in another corporation referred to in this paragraph as 'subsidiary corporation'), the following stock of the subsidiary corporation shall be treated as excluded stock—

"(i) stock in the subsidiary corporation held by a trust which is part of a plan of deferred compensation for the benefit of the employees of the parent corporation or the subsidiary corporation,

"(ii) stock in the subsidiary corporation owned by an individual (within the meaning of subsection (d) (2), but not including stock owned by the parent corporation which is constructively owned by such individual) who is a principal stockholder or officer of the parent corporation. For purposes of this clause, the term 'principal stockholder' of a corporation means an individual who owns (within the meaning of subsection (d) (2)) 5 percent or more of the total combined voting power of all classes of stock entitled to vote or 5 percent or more of the total value of shares of all classes of stock in such corporation; or

"(iii) stock in the subsidiary corporation owned (within the meaning of subsection (d) (2)) by an employee of the subsidiary corporation if such stock is subject to conditions which run in favor of such parent (or subsidiary) corporation and which substantially restrict or limit the employee's right (or if the employee construc-

tively owns such stock, the direct owner's right) to dispose of such stock.

"(B) BROTHER-SISTER CONTROLLED GROUP.—For purposes of subsection (a) (2), if a person who is an individual, estate, or trust (referred to in this paragraph as 'common owner') owns (within the meaning of subsection (d) (2)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in a corporation, the following stock of such corporation shall be treated as excluded stock—

"(1) stock in such corporation held by an employees' trust described in section 401 (a) which is exempt from tax under section 501 (a), if such trust is for the benefit of the employees of such corporation, or

"(ii) stock in such corporation owned (within the meaning of subsection (d) (2)) by an employee of the corporation if such stock is subject to conditions which run in favor of such common owner (or such corporation) and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock. If a condition which limits or restricts the employee's right (or the direct owner's right) to dispose of such stock also applies to the stock held by the common owner pursuant to a bona fide reciprocal stock purchase arrangement, such condition shall not be treated as one which restricts or limits the employee's right to dispose of such stock.

"(d) RULES FOR DETERMINING STOCK OWNERSHIP.—

"(1) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of determining whether a corporation is a member of a parent-subsidiary controlled group of corporations (within the meaning of subsection (a) (1)), stock owned by a corporation means—

"(A) stock owned directly by such corporation, and

"(B) stock owned with the application of subsection (e) (1).

"(2) BROTHER-SISTER CONTROLLED GROUP.—For purposes of determining whether a corporation is a member of a brother-sister controlled group of corporations (within the meaning of subsection (a) (2)), stock owned by a person who is an individual, estate, or trust means—

"(A) stock owned directly by such person, and

"(B) stock owned with the application of subsection (e).

"(e) CONSTRUCTIVE OWNERSHIP.—

"(1) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

"(2) ATTRIBUTION FROM PARTNERSHIPS.—Stock owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the capital or profits of the partnership in proportion to his interest in capital or profits, whichever such proportion is the greater.

"(3) ATTRIBUTION FROM ESTATES OR TRUSTS.—

"(A) Stock owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary who has an actuarial interest of 5 percent or more in such stock, to the extent of such actuarial interest. For purposes of this subparagraph, the actuarial interest of each beneficiary shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of such stock to satisfy his rights as a beneficiary.

"(B) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

"(C) This paragraph shall not apply to stock owned by any employees' trust described in section 401(a) which is exempt from tax under section 501(a).

"(4) ATTRIBUTION FROM CORPORATIONS.—Stock owned, directly or indirectly, by or for a corporation shall be considered as owned by any person who owns (within the meaning of subsection (d)) 5 percent or more in value of its stock in that proportion which the value of the stock which

such person so owns bears to the value of all the stock in such corporation.

"(5) SPOUSE.—An individual shall be considered as owning stock in a corporation owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce whether interlocutory or final, or a decree of separate maintenance), except in the case of a corporation with respect to which each of the following conditions is satisfied for its taxable year—

"(A) The individual does not, at any time during such taxable year, own directly any stock in such corporation;

"(B) The individual is not a director or employee and does not participate in the management of such corporation at any time during such taxable year;

"(C) Not more than 50 percent of such corporation's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities and

"(D) The stock in such corporation is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock and which run in favor of the individual or his children who have not attained the age of 21 years.

"(6) CHILDREN, GRANDCHILDREN, PARENTS, AND GRANDPARENTS.—

"(A) MINOR CHILDREN.—An individual shall be considered as owning stock owned, directly or indirectly, by or for his children who have not attained the age of 21 years, and, if the individual has not attained the age of 21 years, the stock owned, directly or indirectly, by or for his parents.

"(B) ADULT CHILDREN AND GRANDCHILDREN.—An individual who owns (within the meaning of subsection (d) (2), but without regard to this subparagraph) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock in a corporation shall be considered as owning the stock in such corporation owned, directly or indirectly, by or for his parents, grandparents, grandchildren, and children who have attained the age of 21 years.

For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual by blood.

"(f) OTHER DEFINITIONS AND RULES.—

"(1) EMPLOYEE DEFINED.—For purposes of this section the term 'employee' has the same meaning such term is given in section 3306(f).

"(2) OPERATING RULES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), (4), (5), or (6) of subsection (e) shall, for purposes of applying such paragraphs, be treated as actually owned by such person.

"(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (5) or (6) of subsection (e) shall not be treated as owned by him for purposes of again applying such paragraphs in order to make another the constructive owner of such stock.

"(3) SPECIAL RULES.—For purposes of this section—

"(A) If stock may be considered as owned by a person under subsection (e) (1) and under any other paragraph of subsection (e), it shall be considered as owned by him under subsection (e) (1).

"(B) If stock is owned (within the meaning of subsection (d)) by two or more persons, such stock shall be considered as owned by the person whose ownership of such stock results in the corporation being a component member of a controlled group. If by reason of the preceding sentence, a corporation would (but for this sentence) become a component member of two controlled groups, it shall be treated as a component member of one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary or his delegate which are consistent with the purposes of this part.

"(4) FRANCHISED CORPORATION.—If—

"(A) a parent corporation (as defined in subsection (c) (2) (A)), or a common owner (as defined in subsection (c) (2) (B)), of a controlled group of corporations is under a duty (arising out of a written agree-

ment) to sell stock of a corporation (referred to in this paragraph as 'franchised corporation') which is franchised to sell the products of another member, or the common owner, of such controlled group;

"(B) such stock is to be sold to an employee (or employees) of such franchised corporation pursuant to a bona fide plan designed to eliminate the stock ownership of the parent corporation or of the common owner in the franchised corporation;

"(C) such plan—

"(i) provides a reasonable selling price for such stock, and

"(ii) requires that a portion of the employee's share of the profits of such corporation (whether received as compensation or as a dividend) be applied to the purchase of such stock (or the purchase of notes, bonds, debentures or other similar evidence of indebtedness of such franchised corporation held by such parent corporation or common owner);

"(D) such employee (or employees) owns directly more than 20 percent of the total value of shares of all classes of stock in such franchised corporation;

"(E) more than 50 percent of the inventory of such franchised corporation is acquired from members of the controlled group, the common owner, or both; and

"(F) all of the conditions contained in subparagraphs (A), (B), (C), (D), and (E) have been met for one-half (or more) of the number of days preceding the December 31 included within the taxable year (or if the taxable year does not include December 31, the last day of such year) of the franchised corporation,

then such franchised corporation shall be treated as an excluded member of such group, under subsection (b) (2), for such taxable year."

(b) **DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.**—Section 1551 (relating to disallowance of surtax exemption and accumulated earnings credit) is amended to read as follows:

**"SEC. 1551. DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.**

"(a) **IN GENERAL.**—If—

"(1) any corporation transfers, on or after January 1, 1951, and on or before June 12, 1963, all or part of its property (other than money) to a transferee corporation,

"(2) any corporation transfers, directly or indirectly, after June 12, 1963, all or part of its property (other than money) to a transferee corporation, or

"(3) five or fewer individuals who are in control of a corporation transfer, directly or indirectly, after June 12, 1963, property (other than money) to a transferee corporation,

and the transferee corporation was created for the purpose of acquiring such property or was not actively engaged in business at the time of such acquisition, and if after such transfer the transferor or transferors are in control of such transferee corporation during any part of the taxable year of such transferee corporation, then for such taxable year of such transferee corporation the Secretary or his delegate may (except as may be otherwise determined under subsection (d)) disallow the surtax exemption (as defined in section 11(d)), or the \$100,000 accumulated earnings credit provided in paragraph (2) or (3) of section 535(c), unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of such transfer.

"(b) **CONTROL.**—For purposes of subsection (a), the term 'control' means—

"(1) With respect to a transferee corporation described in subsection (a) (1) or (2), the ownership by the transferor corporation, its shareholders, or both, of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock; or

"(2) With respect to each corporation described in subsection (a) (3), the ownership by the five or fewer individuals described in such subsection of stock possessing—

"(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and

“(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such individual only to the extent such stock ownership is identical with respect to each such corporation.

For purposes of this subsection, section 1563(c) shall apply in determining the ownership of stock.

“(c) CORPORATIONS ELECTING MULTIPLE SURTAX EXEMPTIONS.—If the surtax exemption is disallowed to a transferee corporation for any taxable year, section 1562(b) shall not apply with respect to such transferee corporation for such taxable year.

“(d) AUTHORITY OF THE SECRETARY UNDER THIS SECTION.—The provisions of section 269(b), and the authority of the Secretary under such section, shall, to the extent not inconsistent with the provisions of this section, be applicable to this section.”

(c) TECHNICAL AMENDMENTS.—

(1) AMENDMENT OF SECTION 802.—The second sentence of section 802(a)

(1) (relating to tax on life insurance companies) is amended to read as follows: “Such tax shall consist of a normal tax and surtax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11.”

(2) AMENDMENT OF SECTION 269.—Section 269(a) (relating to acquisitions made to evade or avoid income tax) is amended—

(A) by striking out “then such deduction, credit, or other allowance shall not be allowed” at the end of the first sentence and inserting in lieu thereof “then the Secretary or his delegate may disallow such deduction, credit, or other allowance”; and

(B) by adding at the end thereof the following new subsection:

“(d) CORPORATIONS ELECTING MULTIPLE SURTAX EXEMPTIONS.—If the surtax exemption is disallowed to an acquired corporation under subsection (a) for any taxable year, section 1562(b) shall not apply with respect to such acquired corporation for such taxable year.”

(3) SPECIAL RULE FOR 52-53-WEEK YEAR.—Section 441(f)(2)(A) (relating to effective date with respect to special rules for 52-53-week year) is amended by striking out “In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning or ending with reference to a specified date” and inserting in lieu thereof “In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning, including, or ending with reference to a specified date”.

(4) Subchapter B of chapter 6 is amended by inserting after the heading and before the table of sections the following:

“Part I. In general.

“Part II. Certain controlled corporations.

“PART I—IN GENERAL”

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (c) shall apply with respect to taxable years ending after December 31, 1963. The amendment made by subsection (b) shall apply with respect to transfers made after June 12, 1963.

### Title III—Optional Tax On Individuals; Collection Of Income Tax At Source On Wages

#### SEC. 301. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS LESS THAN \$5,000.

(a) OPTIONAL TAX.—Section 3 (relating to optional tax if adjusted gross income is less than \$5,000) is amended to read as follows:

#### “SEC. 3. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS LESS THAN \$5,000.

“(a) TAXABLE YEARS BEGINNING IN 1964.—In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year beginning on or after January 1, 1964, and before January 1, 1965, on the taxable income of every individual whose adjusted gross income for such year is less than \$5,000 and who has elected for such year to pay the tax imposed by this section, a tax as follows:









"TABLE IV—Married Persons Filing SEPARATE Returns

"10 PERCENT STANDARD DEDUCTION

"Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
\$0	\$675	\$0	\$0	\$0	\$0	\$2,325	\$2,350	\$251	\$147	\$49	\$0	\$0	\$0	\$0	\$0
675	700	3	0	0	0	2,350	2,375	255	150	52	0	0	0	0	0
700	725	7	0	0	0	2,375	2,400	259	154	56	0	0	0	0	0
725	750	10	0	0	0	2,400	2,425	263	158	59	0	0	0	0	0
750	775	14	0	0	0	2,425	2,450	267	161	63	0	0	0	0	0
775	800	17	0	0	0	2,450	2,475	271	165	67	0	0	0	0	0
800	825	21	0	0	0	2,475	2,500	275	169	70	0	0	0	0	0
825	850	25	0	0	0	2,500	2,525	279	173	75	0	0	0	0	0
850	875	28	0	0	0	2,525	2,550	283	177	77	0	0	0	0	0
875	900	32	0	0	0	2,550	2,575	287	181	81	0	0	0	0	0
900	925	35	0	0	0	2,575	2,600	291	185	85	0	0	0	0	0
925	950	39	0	0	0	2,600	2,625	295	189	88	0	0	0	0	0
950	975	43	0	0	0	2,625	2,650	299	193	92	0	0	0	0	0
975	1,000	46	0	0	0	2,650	2,675	303	197	96	0	0	0	0	0
1,000	1,025	50	0	0	0	2,675	2,700	307	201	100	3	0	0	0	0
1,025	1,050	53	0	0	0	2,700	2,725	311	205	103	7	0	0	0	0
1,050	1,075	57	0	0	0	2,725	2,750	315	209	107	10	0	0	0	0
1,075	1,100	61	0	0	0	2,750	2,775	320	213	111	14	0	0	0	0
1,100	1,125	64	0	0	0	2,775	2,800	324	217	114	17	0	0	0	0
1,125	1,150	68	0	0	0	2,800	2,825	328	220	118	21	0	0	0	0
1,150	1,175	71	0	0	0	2,825	2,850	332	224	122	25	0	0	0	0
1,175	1,200	75	0	0	0	2,850	2,875	336	228	126	28	0	0	0	0
1,200	1,225	79	0	0	0	2,875	2,900	340	232	129	32	0	0	0	0
1,225	1,250	82	0	0	0	2,900	2,925	344	236	133	35	0	0	0	0
1,250	1,275	86	0	0	0	2,925	2,950	349	240	137	39	0	0	0	0
1,275	1,300	90	0	0	0	2,950	2,975	353	244	140	43	0	0	0	0
1,300	1,325	93	0	0	0	2,975	3,000	358	248	144	46	0	0	0	0
1,325	1,350	97	1	0	0	3,000	3,050	365	254	150	52	0	0	0	0
1,350	1,375	101	4	0	0	3,050	3,100	374	262	157	59	0	0	0	0
1,375	1,400	105	8	0	0	3,100	3,150	383	270	165	66	0	0	0	0
1,400	1,425	108	11	0	0	3,150	3,200	392	278	173	73	0	0	0	0
1,425	1,450	112	15	0	0	3,200	3,250	401	286	180	80	0	0	0	0
1,450	1,475	116	19	0	0	3,250	3,300	410	295	188	88	0	0	0	0
1,475	1,500	119	22	0	0	3,300	3,350	419	303	196	95	0	0	0	0
1,500	1,525	123	26	0	0	3,350	3,400	428	311	204	103	0	0	0	0
1,525	1,550	127	29	0	0	3,400	3,450	437	319	212	110	13	0	0	0
1,550	1,575	131	33	0	0	3,450	3,500	446	327	220	118	20	0	0	0
1,575	1,600	134	37	0	0	3,500	3,550	455	335	228	125	28	0	0	0
1,600	1,625	138	40	0	0	3,550	3,600	464	344	236	132	35	0	0	0
1,625	1,650	142	44	0	0	3,600	3,650	473	353	243	140	42	0	0	0
1,650	1,675	145	47	0	0	3,650	3,700	482	362	251	147	49	0	0	0
1,675	1,700	149	51	0	0	3,700	3,750	491	371	259	155	56	0	0	0
1,700	1,725	153	55	0	0	3,750	3,800	500	380	268	162	64	0	0	0
1,725	1,750	157	58	0	0	3,800	3,850	509	389	276	170	71	0	0	0
1,750	1,775	160	62	0	0	3,850	3,900	518	398	284	178	78	0	0	0
1,775	1,800	164	65	0	0	3,900	3,950	527	407	292	186	85	0	0	0
1,800	1,825	168	69	0	0	3,950	4,000	536	416	300	194	93	0	0	0
1,825	1,850	172	73	0	0	4,000	4,050	545	425	308	201	100	4	0	0
1,850	1,875	176	76	0	0	4,050	4,100	554	434	316	209	108	11	0	0
1,875	1,900	180	80	0	0	4,100	4,150	563	443	324	217	116	18	0	0
1,900	1,925	184	84	0	0	4,150	4,200	572	452	332	225	122	25	0	0
1,925	1,950	188	87	0	0	4,200	4,250	581	461	341	233	130	32	0	0
1,950	1,975	192	91	0	0	4,250	4,300	590	470	350	241	137	40	0	0
1,975	2,000	196	95	0	0	4,300	4,350	599	479	359	249	145	47	0	0
2,000	2,025	199	98	2	0	4,350	4,400	608	488	368	257	152	54	0	0
2,025	2,050	203	102	5	0	4,400	4,450	617	497	377	265	160	61	0	0
2,050	2,075	207	106	9	0	4,450	4,500	626	506	386	273	167	68	0	0
2,075	2,100	211	109	13	0	4,500	4,550	635	515	395	281	175	76	0	0
2,100	2,125	215	113	16	0	4,550	4,600	644	524	404	289	183	83	0	0
2,125	2,150	219	117	20	0	4,600	4,650	653	533	413	297	191	90	0	0
2,150	2,175	223	121	23	0	4,650	4,700	662	542	422	305	199	98	1	0
2,175	2,200	227	124	27	0	4,700	4,750	671	551	431	313	207	105	8	0
2,200	2,225	231	128	31	0	4,750	4,800	680	560	440	322	215	113	16	0
2,225	2,250	235	132	34	0	4,800	4,850	689	569	449	330	222	120	23	0
2,250	2,275	239	135	38	0	4,850	4,900	698	578	458	338	230	127	30	0
2,275	2,300	243	139	41	0	4,900	4,950	707	587	467	347	238	135	37	0
2,300	2,325	247	143	46	0	4,950	5,000	716	596	476	356	246	142	44	0











"Table IV—Married Persons Filing SEPARATE Returns

"10 PERCENT STANDARD DEDUCTION

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
\$0	\$675	\$0	\$0	\$0	\$0	\$2,325	\$2,350	\$228	\$131	\$43	\$0	\$0	\$0	\$0	\$0
675	700	3	0	0	0	2,350	2,375	229	134	40	0	0	0	0	0
700	725	6	0	0	0	2,375	2,400	233	137	49	0	0	0	0	0
725	750	9	0	0	0	2,400	2,425	237	141	52	0	0	0	0	0
750	775	12	0	0	0	2,425	2,450	241	144	58	0	0	0	0	0
775	800	15	0	0	0	2,450	2,475	245	148	58	0	0	0	0	0
800	825	18	0	0	0	2,475	2,500	249	151	61	0	0	0	0	0
825	850	22	0	0	0	2,500	2,525	252	155	65	0	0	0	0	0
850	875	25	0	0	0	2,525	2,550	256	158	68	0	0	0	0	0
875	900	28	0	0	0	2,550	2,575	260	162	71	0	0	0	0	0
900	925	31	0	0	0	2,575	2,600	264	166	74	0	0	0	0	0
925	950	34	0	0	0	2,600	2,625	268	169	78	0	0	0	0	0
950	975	37	0	0	0	2,625	2,650	272	173	81	0	0	0	0	0
975	1,000	40	0	0	0	2,650	2,675	275	176	84	0	0	0	0	0
1,000	1,025	44	0	0	0	2,675	2,700	279	180	88	3	0	0	0	0
1,025	1,050	47	0	0	0	2,700	2,725	283	184	91	6	0	0	0	0
1,050	1,075	50	0	0	0	2,725	2,750	287	187	95	0	0	0	0	0
1,075	1,100	53	0	0	0	2,750	2,775	291	191	98	12	0	0	0	0
1,100	1,125	56	0	0	0	2,775	2,800	294	194	101	15	0	0	0	0
1,125	1,150	59	0	0	0	2,800	2,825	298	198	105	18	0	0	0	0
1,150	1,175	62	0	0	0	2,825	2,850	302	202	108	22	0	0	0	0
1,175	1,200	66	0	0	0	2,850	2,875	306	205	111	25	0	0	0	0
1,200	1,225	69	0	0	0	2,875	2,900	310	209	115	28	0	0	0	0
1,225	1,250	72	0	0	0	2,900	2,925	314	212	118	31	0	0	0	0
1,250	1,275	75	0	0	0	2,925	2,950	318	216	122	34	0	0	0	0
1,275	1,300	79	0	0	0	2,950	2,975	323	220	125	37	0	0	0	0
1,300	1,325	82	0	0	0	2,975	3,000	327	223	128	40	0	0	0	0
1,325	1,350	86	1	0	0	3,000	3,050	333	229	133	45	0	0	0	0
1,350	1,375	89	4	0	0	3,050	3,100	342	236	140	51	0	0	0	0
1,375	1,400	92	7	0	0	3,100	3,150	350	244	147	58	0	0	0	0
1,400	1,425	96	10	0	0	3,150	3,200	359	252	154	64	0	0	0	0
1,425	1,450	99	13	0	0	3,200	3,250	367	259	161	70	0	0	0	0
1,450	1,475	102	16	0	0	3,250	3,300	376	267	169	77	0	0	0	0
1,475	1,500	106	19	0	0	3,300	3,350	385	275	176	84	0	0	0	0
1,500	1,525	109	23	0	0	3,350	3,400	393	282	183	91	5	0	0	0
1,525	1,550	113	26	0	0	3,400	3,450	402	290	190	97	12	0	0	0
1,550	1,575	116	29	0	0	3,450	3,500	410	298	197	104	18	0	0	0
1,575	1,600	119	32	0	0	3,500	3,550	419	305	205	111	24	0	0	0
1,600	1,625	123	35	0	0	3,550	3,600	427	313	212	118	30	0	0	0
1,625	1,650	126	38	0	0	3,600	3,650	436	322	219	124	37	0	0	0
1,650	1,675	129	41	0	0	3,650	3,700	444	330	226	131	43	0	0	0
1,675	1,700	133	45	0	0	3,700	3,750	453	339	234	138	49	0	0	0
1,700	1,725	136	48	0	0	3,750	3,800	462	348	242	145	56	0	0	0
1,725	1,750	140	51	0	0	3,800	3,850	470	356	249	152	62	0	0	0
1,750	1,775	143	54	0	0	3,850	3,900	479	365	257	159	68	0	0	0
1,775	1,800	146	57	0	0	3,900	3,950	487	373	265	166	75	0	0	0
1,800	1,825	150	60	0	0	3,950	4,000	496	382	272	173	82	0	0	0
1,825	1,850	154	64	0	0	4,000	4,050	504	390	280	181	88	3	0	0
1,850	1,875	157	67	0	0	4,050	4,100	513	399	287	188	95	9	0	0
1,875	1,900	161	70	0	0	4,100	4,150	521	407	295	195	102	16	0	0
1,900	1,925	164	73	0	0	4,150	4,200	530	416	303	202	109	22	0	0
1,925	1,950	168	77	0	0	4,200	4,250	538	421	310	209	115	28	0	0
1,950	1,975	172	80	0	0	4,250	4,300	547	433	319	217	122	35	0	0
1,975	2,000	175	83	0	0	4,300	4,350	556	442	328	224	129	41	0	0
2,000	2,025	179	87	2	0	4,350	4,400	564	450	336	231	136	47	0	0
2,025	2,050	182	90	5	0	4,400	4,450	573	459	345	239	142	54	0	0
2,050	2,075	186	93	8	0	4,450	4,500	581	467	353	247	149	60	0	0
2,075	2,100	190	97	11	0	4,500	4,550	590	476	362	254	157	66	0	0
2,100	2,125	193	100	14	0	4,550	4,600	598	484	370	262	164	73	0	0
2,125	2,150	197	104	17	0	4,600	4,650	607	493	379	270	171	79	0	0
2,150	2,175	200	107	20	0	4,650	4,700	615	501	387	277	178	86	1	0
2,175	2,200	204	110	24	0	4,700	4,750	624	510	396	285	185	93	7	0
2,200	2,225	208	114	27	0	4,750	4,800	633	519	405	293	193	100	14	0
2,225	2,250	211	117	30	0	4,800	4,850	641	527	413	300	200	106	20	0
2,250	2,275	215	120	33	0	4,850	4,900	650	536	422	308	207	113	26	0
2,275	2,300	218	124	36	0	4,900	4,950	658	544	430	316	214	120	33	0
2,300	2,325	222	127	39	0	4,950	5,000	667	553	439	325	221	127	39	0



**(b) RULES FOR OPTIONAL TAX.—**

(1) **HUSBAND OF WIFE FILING SEPARATE RETURNS.**—Subsection (c) of section 4 (relating to rules for optional tax) is amended to read as follows:

**"(c) HUSBAND OR WIFE FILING SEPARATE RETURN.—**

"(1) A husband or wife may not elect to pay the optional tax imposed by section 3 if the tax of the other spouse is determined under section 1 on the basis of taxable income computed without regard to the standard deduction.

"(2) Except as otherwise provided in this subsection, in the case of a husband or wife filing a separate return the tax imposed by section 3 shall be—

"(A) for taxable years beginning in 1964, the lesser of the tax shown in Table IV or Table V of section 3(a), and

"(B) for taxable years beginning after December 31, 1963, the lesser of the tax shown in Table IV or Table V of section 3(b).

"(3) Neither Table V of section 3(a) nor Table V of section 3(b) shall apply in the case of a husband or wife filing a separate return if the tax of the other spouse is determined with regard to the 10-percent standard deduction; except that an individual described in section 141(d)(2) may elect (under regulations prescribed by the Secretary or his delegate)—

"(A) to pay the tax shown in Table V of section 3(a) in lieu of the tax shown in Table IV of section 3(a), and

"(B) to pay the tax shown in Table V of section 3(b) in lieu of the tax shown in Table IV of section 3(b).

For purposes of this title, an election under the preceding sentence shall be treated as an election made under section 141(d)(2).

"(4) For purposes of this subsection, determination of marital status shall be made under section 143."

(2) **AMENDMENT OF SECTION 6014.**—Section 6014(a) (relating to income tax return—tax not computed by taxpayer) is amended by adding at the end thereof the following new sentence: "In the case of a married individual filing a separate return and electing the benefits of this subsection, neither Table V in section 3(a) nor Table V in section 3(b) shall apply."

**(3) TECHNICAL AMENDMENTS.—**

(A) Section (a) of section 4 (relating to rules for optional tax) is amended by striking out "table" and inserting in lieu thereof "tables".

(B) Section 4(f) (relating to cross references) is amended by adding at the end thereof the following new paragraph:

"(4) For nonapplicability of Table V in section 3(a) and Table V in section 3(b) in case where tax is not computed by taxpayer, see section 6014(a)."

(c) **EFFECTIVE DATE.**—Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by this section shall apply to taxable years beginning after December 31, 1963.

**SEC. 302. INCOME TAX COLLECTED AT SOURCE.**

(a) **PERCENTAGE METHOD OF WITHHOLDING.**—Subsection (a) of section 3402 (relating to requirement of withholding) is amended to read as follows:

"(a) **REQUIREMENT OF WITHHOLDING.**—Every employer making payment of wages shall deduct and withhold upon such wages (except as provided in subsection (j)) a tax equal to the following percentage of the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in subsection (b) (1):

"(1) 15 percent in the case of wages paid during the calendar year 1964, and

"(2) 14 percent in the case of wages paid after December 31, 1964."

(b) **WAGE BRACKET WITHHOLDING.**—Paragraph (1) of section 3402(c) (relating to wage bracket withholding) is amended to read as follows:

"(1) (A) **WAGES PAID DURING CALENDAR YEAR 1964.**—At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee during the calendar year 1964 a tax determined in accordance with the following tables, which shall be in lieu of the tax required to be deducted and withheld under subsection (a) :

"If the payroll period with respect to an employee is weekly

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$0.....	\$13.....	15% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$13.....	\$14.....	\$2.00	.10	0	0	0	0	0	0	0	0	0
\$14.....	\$15.....	2.20	.30	0	0	0	0	0	0	0	0	0
\$15.....	\$16.....	2.30	.40	0	0	0	0	0	0	0	0	0
\$16.....	\$17.....	2.50	.60	0	0	0	0	0	0	0	0	0
\$17.....	\$18.....	2.60	.70	0	0	0	0	0	0	0	0	0
\$18.....	\$19.....	2.80	.90	0	0	0	0	0	0	0	0	0
\$19.....	\$20.....	2.90	1.00	0	0	0	0	0	0	0	0	0
\$20.....	\$21.....	3.10	1.20	0	0	0	0	0	0	0	0	0
\$21.....	\$22.....	3.20	1.30	0	0	0	0	0	0	0	0	0
\$22.....	\$23.....	3.40	1.50	0	0	0	0	0	0	0	0	0
\$23.....	\$24.....	3.50	1.60	0	0	0	0	0	0	0	0	0
\$24.....	\$25.....	3.70	1.80	0	0	0	0	0	0	0	0	0
\$25.....	\$26.....	3.80	1.90	0	0	0	0	0	0	0	0	0
\$26.....	\$27.....	4.00	2.10	.10	0	0	0	0	0	0	0	0
\$27.....	\$28.....	4.10	2.20	.30	0	0	0	0	0	0	0	0
\$28.....	\$29.....	4.30	2.40	.40	0	0	0	0	0	0	0	0
\$29.....	\$30.....	4.40	2.50	.60	0	0	0	0	0	0	0	0
\$30.....	\$31.....	4.60	2.70	.70	0	0	0	0	0	0	0	0
\$31.....	\$32.....	4.70	2.80	.90	0	0	0	0	0	0	0	0
\$32.....	\$33.....	4.90	3.00	1.00	0	0	0	0	0	0	0	0
\$33.....	\$34.....	5.00	3.10	1.20	0	0	0	0	0	0	0	0
\$34.....	\$35.....	5.20	3.30	1.30	0	0	0	0	0	0	0	0
\$35.....	\$36.....	5.30	3.40	1.50	0	0	0	0	0	0	0	0
\$36.....	\$37.....	5.50	3.60	1.60	0	0	0	0	0	0	0	0
\$37.....	\$38.....	5.60	3.70	1.80	0	0	0	0	0	0	0	0
\$38.....	\$39.....	5.80	3.90	1.90	0	0	0	0	0	0	0	0
\$39.....	\$40.....	5.90	4.00	2.10	.20	0	0	0	0	0	0	0
\$40.....	\$41.....	6.10	4.20	2.20	.30	0	0	0	0	0	0	0
\$41.....	\$42.....	6.20	4.30	2.40	.50	0	0	0	0	0	0	0
\$42.....	\$43.....	6.40	4.50	2.60	.60	0	0	0	0	0	0	0
\$43.....	\$44.....	6.50	4.60	2.70	.80	0	0	0	0	0	0	0
\$44.....	\$45.....	6.70	4.80	2.80	.90	0	0	0	0	0	0	0
\$45.....	\$46.....	6.80	4.90	3.00	1.10	0	0	0	0	0	0	0
\$46.....	\$47.....	7.00	5.10	3.10	1.20	0	0	0	0	0	0	0
\$47.....	\$48.....	7.10	5.20	3.30	1.40	0	0	0	0	0	0	0
\$48.....	\$49.....	7.30	5.40	3.40	1.50	0	0	0	0	0	0	0
\$49.....	\$50.....	7.40	5.50	3.60	1.70	0	0	0	0	0	0	0
\$50.....	\$51.....	7.60	5.70	3.70	1.80	0	0	0	0	0	0	0
\$51.....	\$52.....	7.70	5.80	3.90	2.00	0	0	0	0	0	0	0
\$52.....	\$53.....	7.90	6.00	4.00	2.10	.20	0	0	0	0	0	0
\$53.....	\$54.....	8.00	6.10	4.20	2.30	.30	0	0	0	0	0	0
\$54.....	\$55.....	8.20	6.30	4.30	2.40	.50	0	0	0	0	0	0
\$55.....	\$56.....	8.30	6.40	4.50	2.60	.60	0	0	0	0	0	0

"If the payroll period with respect to an employee is weekly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$56.....	\$57.....	\$8.50	\$6.00	\$4.00	\$2.70	\$ .80	\$0	\$0	\$0	\$0	\$0	\$0
\$57.....	\$58.....	8.60	6.70	4.80	2.90	.90	0	0	0	0	0	0
\$58.....	\$59.....	8.80	6.90	4.90	3.00	1.10	0	0	0	0	0	0
\$59.....	\$60.....	8.90	7.00	5.10	3.20	1.20	0	0	0	0	0	0
\$60.....	\$62.....	9.20	7.20	5.30	3.40	1.60	0	0	0	0	0	0
\$62.....	\$64.....	9.60	7.50	5.60	3.70	1.80	0	0	0	0	0	0
\$64.....	\$65.....	9.60	7.80	5.90	4.00	2.10	.10	0	0	0	0	0
\$65.....	\$68.....	10.10	8.10	6.20	4.30	2.40	.40	0	0	0	0	0
\$68.....	\$70.....	10.40	8.40	6.50	4.60	2.70	.70	0	0	0	0	0
\$70.....	\$72.....	10.70	8.70	6.80	4.90	3.00	1.00	0	0	0	0	0
\$72.....	\$74.....	11.00	9.00	7.10	5.20	3.30	1.30	0	0	0	0	0
\$74.....	\$76.....	11.30	9.30	7.40	5.50	3.60	1.60	0	0	0	0	0
\$76.....	\$78.....	11.60	9.60	7.70	5.80	3.90	1.90	0	0	0	0	0
\$78.....	\$80.....	11.90	9.90	8.00	6.10	4.20	2.20	.30	0	0	0	0
\$80.....	\$82.....	12.20	10.20	8.30	6.40	4.50	2.50	.60	0	0	0	0
\$82.....	\$84.....	12.50	10.50	8.60	6.70	4.80	2.80	.90	0	0	0	0
\$84.....	\$86.....	12.80	10.80	8.90	7.00	5.10	3.10	1.20	0	0	0	0
\$86.....	\$88.....	13.10	11.10	9.20	7.30	5.40	3.40	1.50	0	0	0	0
\$88.....	\$90.....	13.40	11.40	9.50	7.60	5.70	3.70	1.80	0	0	0	0
\$90.....	\$92.....	13.70	11.70	9.80	7.90	6.00	4.00	2.10	.20	0	0	0
\$92.....	\$94.....	14.00	12.00	10.10	8.20	6.30	4.30	2.40	.50	0	0	0
\$94.....	\$96.....	14.30	12.30	10.40	8.50	6.60	4.60	2.70	.80	0	0	0
\$96.....	\$98.....	14.60	12.60	10.70	8.80	6.90	4.90	3.00	1.10	0	0	0
\$98.....	\$100.....	14.90	12.90	11.00	9.10	7.20	5.20	3.30	1.40	0	0	0
\$100.....	\$105.....	15.40	13.50	11.50	9.60	7.70	5.80	3.80	1.90	0	0	0
\$105.....	\$110.....	16.10	14.20	12.30	10.40	8.40	6.50	4.60	2.70	.70	0	0
\$110.....	\$115.....	16.90	15.00	13.00	11.10	9.20	7.30	5.30	3.40	1.60	0	0
\$115.....	\$120.....	17.60	15.70	13.80	11.90	9.90	8.00	6.10	4.20	2.20	.30	0
\$120.....	\$125.....	18.40	16.50	14.50	12.60	10.70	8.80	6.80	4.90	3.00	1.10	0
\$125.....	\$130.....	19.10	17.20	15.30	13.40	11.40	9.50	7.60	5.70	3.70	1.80	0
\$130.....	\$135.....	19.90	18.00	16.00	14.10	12.20	10.30	8.30	6.40	4.50	2.60	.00
\$135.....	\$140.....	20.60	18.70	16.80	14.90	12.90	11.00	9.10	7.20	5.20	3.30	1.40
\$140.....	\$145.....	21.40	19.50	17.50	15.60	13.70	11.80	9.80	7.90	6.00	4.10	2.10
\$145.....	\$150.....	22.10	20.20	18.30	16.40	14.40	12.50	10.50	8.70	6.70	4.80	2.90
\$150.....	\$160.....	23.30	21.30	19.40	17.50	15.60	13.60	11.70	9.80	7.90	5.90	4.00
\$160.....	\$170.....	24.50	22.50	20.60	19.00	17.10	15.10	13.20	11.30	9.40	7.40	5.50
\$170.....	\$180.....	26.30	24.30	22.40	20.50	18.60	16.60	14.70	12.80	10.90	8.90	7.00
\$180.....	\$190.....	27.80	25.80	23.00	22.00	20.10	18.10	16.20	14.30	12.40	10.40	8.50
\$190.....	\$200.....	29.30	27.30	25.40	23.50	21.60	19.60	17.70	15.80	13.90	11.90	10.00
15 percent of the excess over \$200 plus—												
\$200 and over.....		30.00	28.10	26.20	24.20	22.30	20.40	18.50	16.50	14.00	12.70	10.80

"If the payroll period with respect to an employee is biweekly

And the wages are--		And the number of withholding exemptions claimed is--										
At least--	But less than--	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be--										
\$0-----	\$20-----	15% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$26-----	\$28-----	\$1.10	.20	0	0	0	0	0	0	0	0	0
\$28-----	\$30-----	4.40	.50	0	0	0	0	0	0	0	0	0
\$30-----	\$32-----	4.70	.80	0	0	0	0	0	0	0	0	0
\$32-----	\$34-----	5.00	1.10	0	0	0	0	0	0	0	0	0
\$34-----	\$36-----	5.30	1.40	0	0	0	0	0	0	0	0	0
\$36-----	\$38-----	5.60	1.70	0	0	0	0	0	0	0	0	0
\$38-----	\$40-----	5.90	2.00	0	0	0	0	0	0	0	0	0
\$40-----	\$42-----	6.20	2.30	0	0	0	0	0	0	0	0	0
\$42-----	\$44-----	6.50	2.60	0	0	0	0	0	0	0	0	0
\$44-----	\$46-----	6.80	2.90	0	0	0	0	0	0	0	0	0
\$46-----	\$48-----	7.10	3.20	0	0	0	0	0	0	0	0	0
\$48-----	\$50-----	7.40	3.50	0	0	0	0	0	0	0	0	0
\$50-----	\$52-----	7.70	3.80	0	0	0	0	0	0	0	0	0
\$52-----	\$54-----	8.00	4.10	.30	0	0	0	0	0	0	0	0
\$54-----	\$56-----	8.30	4.40	.60	0	0	0	0	0	0	0	0
\$56-----	\$58-----	8.60	4.70	.90	0	0	0	0	0	0	0	0
\$58-----	\$60-----	8.90	5.00	1.20	0	0	0	0	0	0	0	0
\$60-----	\$62-----	9.20	5.30	1.50	0	0	0	0	0	0	0	0
\$62-----	\$64-----	9.50	5.60	1.80	0	0	0	0	0	0	0	0
\$64-----	\$66-----	9.80	5.90	2.10	0	0	0	0	0	0	0	0
\$66-----	\$68-----	10.10	6.20	2.40	0	0	0	0	0	0	0	0
\$68-----	\$70-----	10.40	6.50	2.70	0	0	0	0	0	0	0	0
\$70-----	\$72-----	10.70	6.80	3.00	0	0	0	0	0	0	0	0
\$72-----	\$74-----	11.00	7.10	3.30	0	0	0	0	0	0	0	0
\$74-----	\$76-----	11.30	7.40	3.60	0	0	0	0	0	0	0	0
\$76-----	\$78-----	11.60	7.70	3.90	0	0	0	0	0	0	0	0
\$78-----	\$80-----	11.90	8.00	4.20	.30	0	0	0	0	0	0	0
\$80-----	\$82-----	12.20	8.30	4.50	.60	0	0	0	0	0	0	0
\$82-----	\$84-----	12.50	8.60	4.80	.90	0	0	0	0	0	0	0
\$84-----	\$86-----	12.80	8.90	5.10	1.20	0	0	0	0	0	0	0
\$86-----	\$88-----	13.10	9.20	5.40	1.50	0	0	0	0	0	0	0
\$88-----	\$90-----	13.40	9.50	5.70	1.80	0	0	0	0	0	0	0
\$90-----	\$92-----	13.70	9.80	6.00	2.10	0	0	0	0	0	0	0
\$92-----	\$94-----	14.00	10.10	6.30	2.40	0	0	0	0	0	0	0
\$94-----	\$96-----	14.30	10.40	6.60	2.70	0	0	0	0	0	0	0
\$96-----	\$98-----	14.60	10.70	6.90	3.00	0	0	0	0	0	0	0
\$98-----	\$100-----	14.90	11.00	7.20	3.30	0	0	0	0	0	0	0
\$100-----	\$102-----	15.20	11.30	7.50	3.60	0	0	0	0	0	0	0
\$102-----	\$104-----	15.50	11.60	7.80	3.90	.10	0	0	0	0	0	0
\$104-----	\$106-----	15.80	11.90	8.10	4.20	.40	0	0	0	0	0	0
\$106-----	\$108-----	16.10	12.20	8.40	4.50	.70	0	0	0	0	0	0
\$108-----	\$110-----	16.40	12.50	8.70	4.80	1.00	0	0	0	0	0	0
\$110-----	\$112-----	16.70	12.80	9.00	5.10	1.30	0	0	0	0	0	0
\$112-----	\$114-----	17.00	13.10	9.30	5.40	1.60	0	0	0	0	0	0

"If the payroll period with respect to an employee is biweekly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$114.....	\$116.....	\$17.30	\$13.40	\$9.60	\$5.70	\$1.90	\$0	\$0	\$0	\$0	\$0	\$0
\$116.....	\$118.....	17.00	13.70	9.90	6.00	2.20	0	0	0	0	0	0
\$118.....	\$120.....	17.00	14.00	10.20	6.30	2.50	0	0	0	0	0	0
\$120.....	\$124.....	18.30	14.50	10.60	6.80	2.90	0	0	0	0	0	0
\$124.....	\$128.....	18.90	15.10	11.20	7.40	3.50	0	0	0	0	0	0
\$128.....	\$132.....	19.50	15.70	11.80	8.00	4.10	.30	0	0	0	0	0
\$132.....	\$136.....	23.10	16.30	12.40	8.60	4.70	.90	0	0	0	0	0
\$136.....	\$140.....	20.70	16.90	13.00	9.20	5.30	1.50	0	0	0	0	0
\$140.....	\$144.....	21.30	17.50	13.60	9.80	5.90	2.10	0	0	0	0	0
\$144.....	\$148.....	21.90	18.10	14.20	10.40	6.50	2.70	0	0	0	0	0
\$148.....	\$152.....	22.50	18.70	14.80	11.00	7.10	3.30	0	0	0	0	0
\$152.....	\$156.....	23.10	19.30	15.40	11.60	7.70	3.90	0	0	0	0	0
\$156.....	\$160.....	23.70	19.90	16.00	12.20	8.30	4.50	.60	0	0	0	0
\$160.....	\$164.....	24.30	20.50	16.60	12.80	8.90	5.10	1.20	0	0	0	0
\$164.....	\$168.....	24.90	21.10	17.20	13.40	9.50	5.70	1.80	0	0	0	0
\$168.....	\$172.....	25.50	21.70	17.80	14.00	10.10	6.30	2.40	0	0	0	0
\$172.....	\$176.....	23.10	22.30	18.40	14.60	10.70	6.90	3.00	0	0	0	0
\$176.....	\$180.....	26.70	22.90	19.00	15.20	11.30	7.50	3.60	0	0	0	0
\$180.....	\$184.....	27.30	23.50	19.60	15.80	11.90	8.10	4.20	.40	0	0	0
\$184.....	\$188.....	27.90	24.10	20.20	16.40	12.50	8.70	4.80	1.00	0	0	0
\$188.....	\$192.....	28.50	24.70	20.80	17.00	13.10	9.30	5.40	1.60	0	0	0
\$192.....	\$196.....	29.10	25.30	21.40	17.60	13.70	9.90	6.00	2.20	0	0	0
\$196.....	\$200.....	29.70	25.90	22.00	18.20	14.30	10.50	6.60	2.80	0	0	0
\$200.....	\$204.....	30.80	26.90	23.10	19.20	15.40	11.50	7.70	3.80	0	0	0
\$204.....	\$210.....	32.30	28.40	24.60	20.70	16.90	13.00	9.20	5.30	1.50	0	0
\$210.....	\$220.....	33.80	29.90	26.10	22.20	18.40	14.50	10.70	6.80	3.00	0	0
\$220.....	\$230.....	35.30	31.40	27.60	23.70	19.90	16.00	12.20	8.30	4.50	.60	0
\$230.....	\$240.....	36.80	32.90	29.10	25.20	21.40	17.50	13.70	9.80	6.00	2.10	0
\$240.....	\$250.....	38.30	34.40	30.60	26.70	22.90	19.00	15.20	11.30	7.50	3.60	0
\$250.....	\$260.....	39.80	35.90	32.10	28.20	24.40	20.50	16.70	12.80	9.00	5.10	1.30
\$260.....	\$270.....	41.30	37.40	33.60	29.70	25.90	22.00	18.20	14.30	10.50	6.60	2.80
\$270.....	\$280.....	42.80	38.90	35.10	31.20	27.40	23.50	19.70	15.80	12.00	8.10	4.30
\$280.....	\$290.....	44.30	40.40	36.60	32.70	28.90	25.00	21.20	17.30	13.50	9.60	5.80
\$290.....	\$300.....	46.50	42.70	38.80	35.00	31.10	27.30	23.40	19.60	15.70	11.90	6.00
\$300.....	\$320.....	49.50	45.70	41.80	38.00	34.10	30.30	26.40	22.60	18.70	14.90	11.00
\$320.....	\$340.....	52.50	48.70	44.80	41.00	37.10	33.30	29.40	25.60	21.70	17.90	14.00
\$340.....	\$360.....	55.50	51.70	47.80	44.00	40.10	36.30	32.40	28.60	24.70	20.90	17.00
\$360.....	\$400.....	58.50	54.70	50.80	47.00	43.10	39.30	35.40	31.60	27.70	23.90	20.00
15 percent of the excess over \$400 plus—												
\$400 and over.....		60.00	56.20	52.30	48.50	44.60	40.80	36.90	33.10	29.20	25.40	21.50

"If the payroll period with respect to an employee is semimonthly

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$0.....	\$28.....	15% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$28.....	\$30.....	\$4.40	.20	0	0	0	0	0	0	0	0	0
\$30.....	\$32.....	4.70	.60	0	0	0	0	0	0	0	0	0
\$32.....	\$34.....	5.00	.80	0	0	0	0	0	0	0	0	0
\$34.....	\$36.....	5.30	1.10	0	0	0	0	0	0	0	0	0
\$36.....	\$38.....	5.60	1.40	0	0	0	0	0	0	0	0	0
\$38.....	\$40.....	5.90	1.70	0	0	0	0	0	0	0	0	0
\$40.....	\$42.....	6.20	2.00	0	0	0	0	0	0	0	0	0
\$42.....	\$44.....	6.50	2.30	0	0	0	0	0	0	0	0	0
\$44.....	\$46.....	6.80	2.60	0	0	0	0	0	0	0	0	0
\$46.....	\$48.....	7.10	2.90	0	0	0	0	0	0	0	0	0
\$48.....	\$50.....	7.40	3.20	0	0	0	0	0	0	0	0	0
\$50.....	\$52.....	7.70	3.50	0	0	0	0	0	0	0	0	0
\$52.....	\$54.....	8.00	3.80	0	0	0	0	0	0	0	0	0
\$54.....	\$56.....	8.30	4.10	0	0	0	0	0	0	0	0	0
\$56.....	\$58.....	8.60	4.40	.20	0	0	0	0	0	0	0	0
\$58.....	\$60.....	8.90	4.70	.50	0	0	0	0	0	0	0	0
\$60.....	\$62.....	9.20	5.00	.80	0	0	0	0	0	0	0	0
\$62.....	\$64.....	9.50	5.30	1.10	0	0	0	0	0	0	0	0
\$64.....	\$66.....	9.80	5.60	1.40	0	0	0	0	0	0	0	0
\$66.....	\$68.....	10.10	5.90	1.70	0	0	0	0	0	0	0	0
\$68.....	\$70.....	10.40	6.20	2.00	0	0	0	0	0	0	0	0
\$70.....	\$72.....	10.70	6.50	2.30	0	0	0	0	0	0	0	0
\$72.....	\$74.....	11.00	6.80	2.60	0	0	0	0	0	0	0	0
\$74.....	\$76.....	11.30	7.10	2.90	0	0	0	0	0	0	0	0
\$76.....	\$78.....	11.60	7.40	3.20	0	0	0	0	0	0	0	0
\$78.....	\$80.....	11.90	7.70	3.50	0	0	0	0	0	0	0	0
\$80.....	\$82.....	12.20	8.00	3.80	0	0	0	0	0	0	0	0
\$82.....	\$84.....	12.50	8.30	4.10	0	0	0	0	0	0	0	0
\$84.....	\$86.....	12.80	8.60	4.40	.30	0	0	0	0	0	0	0
\$86.....	\$88.....	13.10	8.90	4.70	.60	0	0	0	0	0	0	0
\$88.....	\$90.....	13.40	9.20	5.00	.90	0	0	0	0	0	0	0
\$90.....	\$92.....	13.70	9.60	5.30	1.20	0	0	0	0	0	0	0
\$92.....	\$94.....	14.00	9.80	5.60	1.50	0	0	0	0	0	0	0
\$94.....	\$96.....	14.30	10.10	5.90	1.80	0	0	0	0	0	0	0
\$96.....	\$98.....	14.60	10.40	6.20	2.10	0	0	0	0	0	0	0
\$98.....	\$100.....	14.90	10.70	6.50	2.40	0	0	0	0	0	0	0
\$100.....	\$102.....	15.20	11.00	6.80	2.70	0	0	0	0	0	0	0
\$102.....	\$104.....	15.50	11.30	7.10	3.00	0	0	0	0	0	0	0
\$104.....	\$106.....	15.80	11.60	7.40	3.30	0	0	0	0	0	0	0
\$106.....	\$108.....	16.10	11.90	7.70	3.60	0	0	0	0	0	0	0
\$108.....	\$110.....	16.40	12.20	8.00	3.90	0	0	0	0	0	0	0
\$110.....	\$112.....	16.70	12.60	8.30	4.20	0	0	0	0	0	0	0
\$112.....	\$114.....	17.00	12.80	8.60	4.50	.30	0	0	0	0	0	0
\$114.....	\$116.....	17.30	13.10	8.90	4.80	.60	0	0	0	0	0	0
\$116.....	\$118.....	17.60	13.40	9.20	5.10	.90	0	0	0	0	0	0



"If the payroll period with respect to an employee is semimonthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$118.....	\$120.....	\$17.90	\$13.70	\$9.50	\$5.40	\$1.20	\$0	\$0	\$0	\$0	\$0	\$0
\$120.....	\$124.....	18.30	14.10	10.00	5.80	1.60	0	0	0	0	0	0
\$124.....	\$128.....	18.90	14.70	10.60	6.40	2.20	0	0	0	0	0	0
\$128.....	\$132.....	19.60	15.30	11.20	7.00	2.80	0	0	0	0	0	0
\$132.....	\$136.....	20.10	15.90	11.80	7.60	3.40	0	0	0	0	0	0
\$136.....	\$140.....	20.70	16.50	12.40	8.20	4.00	0	0	0	0	0	0
\$140.....	\$144.....	21.30	17.10	13.00	8.80	4.60	.50	0	0	0	0	0
\$144.....	\$148.....	21.90	17.70	13.60	9.40	5.20	1.10	0	0	0	0	0
\$148.....	\$152.....	22.60	18.30	14.20	10.00	5.80	1.70	0	0	0	0	0
\$152.....	\$156.....	23.10	18.90	14.80	10.60	6.40	2.30	0	0	0	0	0
\$156.....	\$160.....	23.70	19.60	15.40	11.20	7.00	2.90	0	0	0	0	0
\$160.....	\$164.....	24.30	20.10	16.00	11.80	7.60	3.50	0	0	0	0	0
\$164.....	\$168.....	24.90	20.70	16.60	12.40	8.20	4.10	0	0	0	0	0
\$168.....	\$172.....	25.60	21.30	17.20	13.00	8.80	4.70	.50	0	0	0	0
\$172.....	\$176.....	26.10	21.90	17.80	13.60	9.40	5.30	1.10	0	0	0	0
\$176.....	\$180.....	26.70	22.60	18.40	14.20	10.00	5.90	1.70	0	0	0	0
\$180.....	\$184.....	27.30	23.10	19.00	14.80	10.60	6.50	2.30	0	0	0	0
\$184.....	\$188.....	27.90	23.70	19.60	15.40	11.20	7.10	2.90	0	0	0	0
\$188.....	\$192.....	28.60	24.30	20.20	16.00	11.80	7.70	3.60	0	0	0	0
\$192.....	\$196.....	29.10	24.90	20.80	16.60	12.40	8.30	4.10	0	0	0	0
\$196.....	\$200.....	29.70	25.50	21.40	17.20	13.00	8.90	4.70	.50	0	0	0
\$200.....	\$210.....	30.80	26.60	22.40	18.30	14.10	9.60	5.80	1.60	0	0	0
\$210.....	\$220.....	32.30	28.10	23.90	19.80	15.60	11.40	7.30	3.10	0	0	0
\$220.....	\$230.....	33.80	29.60	25.40	21.30	17.10	12.90	8.80	4.60	.40	0	0
\$230.....	\$240.....	35.30	31.10	26.90	22.80	18.10	14.40	10.30	6.10	1.90	0	0
\$240.....	\$250.....	36.80	32.60	28.40	24.80	20.10	15.90	11.80	7.60	3.40	0	0
\$250.....	\$260.....	38.30	34.10	29.90	25.80	21.60	17.40	13.30	9.10	4.90	.80	0
\$260.....	\$270.....	39.80	35.60	31.40	27.30	23.10	18.90	14.80	10.60	6.40	2.30	0
\$270.....	\$280.....	41.30	37.10	32.90	28.80	24.60	20.40	16.30	12.10	7.90	3.80	0
\$280.....	\$290.....	42.80	38.60	34.40	30.30	26.10	21.90	17.80	13.60	9.40	5.30	1.10
\$290.....	\$300.....	44.30	40.10	35.90	31.80	27.60	23.40	19.30	15.10	10.90	6.80	2.60
\$300.....	\$320.....	46.60	42.30	38.20	34.00	29.80	25.70	21.60	17.30	13.20	9.00	4.80
\$320.....	\$340.....	49.50	45.30	41.20	37.00	32.80	28.70	24.60	20.30	16.20	12.00	7.80
\$340.....	\$360.....	52.60	48.30	44.20	40.00	35.80	31.70	27.50	23.30	19.20	15.00	10.80
\$360.....	\$380.....	55.60	51.30	47.20	43.00	38.80	34.70	30.60	26.30	22.20	18.00	13.80
\$380.....	\$400.....	58.60	54.30	50.20	46.00	41.80	37.70	33.60	29.30	25.20	21.00	16.80
\$400.....	\$420.....	61.60	57.30	53.20	49.00	44.80	40.70	36.60	32.30	28.20	24.00	19.80
\$420.....	\$440.....	64.60	60.30	56.20	52.00	47.80	43.70	39.60	35.30	31.20	27.00	22.80
\$440.....	\$460.....	67.60	63.30	59.20	55.00	50.80	46.70	42.60	38.30	34.20	30.00	25.80
\$460.....	\$480.....	70.60	66.30	62.20	58.00	53.80	49.70	45.60	41.30	37.20	33.00	28.80
\$480.....	\$500.....	73.60	69.30	65.20	61.00	56.80	52.70	48.60	44.30	40.20	36.00	31.80
		15 percent of the excess over \$500 plus—										
\$500 and over.....		75.00	70.80	68.70	62.50	58.30	54.20	50.00	45.80	41.70	37.50	33.30

"If the payroll period with respect to an employee is monthly

And the wages are--		And the number of withholding exemptions claimed is--										
At least--	But less than--	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be--										
\$0.....	\$56.....	15% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$56.....	\$60.....	\$8.70	.40	0	0	0	0	0	0	0	0	0
\$60.....	\$64.....	9.30	1.00	0	0	0	0	0	0	0	0	0
\$64.....	\$68.....	9.90	1.60	0	0	0	0	0	0	0	0	0
\$68.....	\$72.....	10.50	2.20	0	0	0	0	0	0	0	0	0
\$72.....	\$76.....	11.10	2.80	0	0	0	0	0	0	0	0	0
\$76.....	\$80.....	11.70	3.40	0	0	0	0	0	0	0	0	0
\$80.....	\$84.....	12.30	4.00	0	0	0	0	0	0	0	0	0
\$84.....	\$88.....	12.90	4.60	0	0	0	0	0	0	0	0	0
\$88.....	\$92.....	13.50	5.20	0	0	0	0	0	0	0	0	0
\$92.....	\$96.....	14.10	5.80	0	0	0	0	0	0	0	0	0
\$96.....	\$100.....	14.70	6.40	0	0	0	0	0	0	0	0	0
\$100.....	\$104.....	15.30	7.00	0	0	0	0	0	0	0	0	0
\$104.....	\$108.....	15.90	7.60	0	0	0	0	0	0	0	0	0
\$108.....	\$112.....	16.50	8.20	0	0	0	0	0	0	0	0	0
\$112.....	\$116.....	17.10	8.80	.40	0	0	0	0	0	0	0	0
\$116.....	\$120.....	17.70	9.40	1.00	0	0	0	0	0	0	0	0
\$120.....	\$124.....	18.30	10.00	1.60	0	0	0	0	0	0	0	0
\$124.....	\$128.....	18.90	10.60	2.20	0	0	0	0	0	0	0	0
\$128.....	\$132.....	19.50	11.20	2.80	0	0	0	0	0	0	0	0
\$132.....	\$136.....	20.10	11.80	3.40	0	0	0	0	0	0	0	0
\$136.....	\$140.....	20.70	12.40	4.00	0	0	0	0	0	0	0	0
\$140.....	\$144.....	21.30	13.00	4.60	0	0	0	0	0	0	0	0
\$144.....	\$148.....	21.90	13.60	5.20	0	0	0	0	0	0	0	0
\$148.....	\$152.....	22.50	14.20	5.80	0	0	0	0	0	0	0	0
\$152.....	\$156.....	23.10	14.80	6.40	0	0	0	0	0	0	0	0
\$156.....	\$160.....	23.70	15.40	7.00	0	0	0	0	0	0	0	0
\$160.....	\$164.....	24.30	16.00	7.60	0	0	0	0	0	0	0	0
\$164.....	\$168.....	24.90	16.60	8.20	0	0	0	0	0	0	0	0
\$168.....	\$172.....	25.50	17.20	8.80	.50	0	0	0	0	0	0	0
\$172.....	\$176.....	26.10	17.80	9.40	1.10	0	0	0	0	0	0	0
\$176.....	\$180.....	26.70	18.40	10.00	1.70	0	0	0	0	0	0	0
\$180.....	\$184.....	27.30	19.00	10.60	2.30	0	0	0	0	0	0	0
\$184.....	\$188.....	27.90	19.60	11.20	2.90	0	0	0	0	0	0	0
\$188.....	\$192.....	28.50	20.20	11.80	3.50	0	0	0	0	0	0	0
\$192.....	\$196.....	29.10	20.80	12.40	4.10	0	0	0	0	0	0	0
\$196.....	\$200.....	29.70	21.40	13.00	4.70	0	0	0	0	0	0	0
\$200.....	\$204.....	30.30	22.00	13.60	5.30	0	0	0	0	0	0	0
\$204.....	\$208.....	30.90	22.60	14.20	5.90	0	0	0	0	0	0	0
\$208.....	\$212.....	31.50	23.20	14.80	6.50	0	0	0	0	0	0	0
\$212.....	\$216.....	32.10	23.80	15.40	7.10	0	0	0	0	0	0	0
\$216.....	\$220.....	32.70	24.40	16.00	7.70	0	0	0	0	0	0	0
\$220.....	\$224.....	33.30	25.00	16.60	8.30	0	0	0	0	0	0	0
\$224.....	\$228.....	33.90	25.60	17.20	8.90	.60	0	0	0	0	0	0
\$228.....	\$232.....	34.50	26.20	17.80	9.50	1.20	0	0	0	0	0	0

"If the payroll period with respect to an employee is monthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$232	\$236	\$35.10	\$26.80	\$18.40	\$10.10	\$1.80	\$0	\$0	\$0	\$0	\$0	\$0
\$236	\$240	35.70	27.40	19.00	10.70	2.40	0	0	0	0	0	0
\$240	\$248	36.60	28.30	19.90	11.60	3.30	0	0	0	0	0	0
\$248	\$256	37.80	29.50	21.10	12.80	4.50	0	0	0	0	0	0
\$256	\$264	39.00	30.70	22.30	14.00	5.70	0	0	0	0	0	0
\$264	\$272	40.20	31.90	23.50	15.20	6.90	0	0	0	0	0	0
\$272	\$280	41.40	33.10	24.70	16.40	8.10	0	0	0	0	0	0
\$280	\$288	42.60	34.30	25.90	17.60	9.30	.90	0	0	0	0	0
\$288	\$296	43.80	35.50	27.10	18.80	10.50	2.10	0	0	0	0	0
\$296	\$304	45.00	36.70	28.30	20.00	11.70	3.30	0	0	0	0	0
\$304	\$312	46.20	37.90	29.50	21.20	12.90	4.50	0	0	0	0	0
\$312	\$320	47.40	39.10	30.70	22.40	14.10	5.70	0	0	0	0	0
\$320	\$328	48.60	40.30	31.90	23.60	15.30	6.90	0	0	0	0	0
\$328	\$336	49.80	41.50	33.10	24.80	16.50	8.10	0	0	0	0	0
\$336	\$344	51.00	42.70	34.30	26.00	17.70	9.30	1.00	0	0	0	0
\$344	\$352	52.20	43.90	35.50	27.20	18.90	10.50	2.20	0	0	0	0
\$352	\$360	53.40	45.10	36.70	28.40	20.10	11.70	3.40	0	0	0	0
\$360	\$368	54.60	46.30	37.90	29.60	21.30	12.90	4.60	0	0	0	0
\$368	\$376	55.80	47.50	39.10	30.80	22.50	14.10	5.80	0	0	0	0
\$376	\$384	57.00	48.70	40.30	32.00	23.70	15.30	7.00	0	0	0	0
\$384	\$392	58.20	49.90	41.50	33.20	24.90	16.50	8.20	0	0	0	0
\$392	\$400	59.40	51.10	42.70	34.40	26.10	17.70	9.40	1.10	0	0	0
\$400	\$408	61.50	53.20	44.80	36.50	28.20	19.80	11.50	3.20	0	0	0
\$408	\$416	61.50	56.20	47.80	39.50	31.20	22.80	14.50	6.20	0	0	0
\$416	\$424	67.50	59.20	50.80	42.50	34.20	25.80	17.50	9.20	.80	0	0
\$424	\$432	70.50	62.20	53.80	45.50	37.20	28.80	20.50	12.20	3.80	0	0
\$432	\$440	73.50	65.20	56.80	48.50	40.20	31.80	23.50	15.20	6.80	0	0
\$440	\$448	76.50	68.20	59.80	51.50	43.20	34.80	26.50	18.20	9.80	1.50	0
\$448	\$456	79.50	71.20	62.80	54.50	46.20	37.80	29.50	21.20	12.80	4.50	0
\$456	\$464	82.50	74.20	65.80	57.50	49.20	40.80	32.50	24.20	15.80	7.50	0
\$464	\$472	85.50	77.20	68.80	60.50	52.20	43.80	35.50	27.20	18.80	10.50	2.20
\$472	\$480	88.50	80.20	71.80	63.50	55.20	46.80	38.50	30.20	21.80	13.50	5.20
\$480	\$488	93.00	81.70	76.30	68.00	59.70	51.30	43.00	31.70	26.30	18.00	9.70
\$488	\$496	97.00	90.70	82.30	71.00	65.70	57.30	49.00	40.70	32.30	24.00	15.70
\$496	\$504	105.00	96.70	88.30	80.00	71.70	63.30	55.00	46.70	38.30	30.00	21.70
\$504	\$512	111.00	102.70	94.30	85.00	77.70	69.30	61.00	52.70	44.30	36.00	27.70
\$512	\$520	117.00	109.70	100.30	92.00	83.70	75.30	67.00	58.70	50.30	42.00	33.70
\$520	\$528	123.00	114.70	106.30	98.00	89.70	81.30	73.00	64.70	56.30	48.00	39.70
\$528	\$536	129.00	120.70	112.30	104.00	95.70	87.30	79.00	70.70	62.30	54.00	45.70
\$536	\$544	135.00	125.70	118.30	110.00	101.70	93.30	85.00	76.70	68.30	60.00	51.70
\$544	\$552	141.00	132.70	124.30	116.00	107.70	99.30	91.00	82.70	74.30	66.00	57.70
\$552	\$560	147.00	138.70	130.30	122.00	113.70	105.30	97.00	88.70	80.30	72.00	63.70
		15 percent of the excess over \$1,000 plus—										
\$1,000 and over		150.00	141.70	133.30	125.00	116.70	108.30	100.00	91.70	83.30	75.00	66.70

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—												
		0	1	2	3	4	5	6	7	8	9	10 or more		
<b>At least—</b>	<b>But less than—</b>	<b>The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—</b>												
		15% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$0	\$2.00	\$0.30	.05	0	0	0	0	0	0	0	0	0	0	0
\$2.00	\$2.25	.35	.10	0	0	0	0	0	0	0	0	0	0	0
\$2.25	\$2.50	.40	.10	0	0	0	0	0	0	0	0	0	0	0
\$2.50	\$2.75	.45	.15	0	0	0	0	0	0	0	0	0	0	0
\$2.75	\$3.00	.50	.20	0	0	0	0	0	0	0	0	0	0	0
\$3.00	\$3.25	.55	.25	0	0	0	0	0	0	0	0	0	0	0
\$3.25	\$3.50	.60	.30	.05	0	0	0	0	0	0	0	0	0	0
\$3.50	\$3.75	.65	.35	.05	0	0	0	0	0	0	0	0	0	0
\$3.75	\$4.00	.70	.40	.10	0	0	0	0	0	0	0	0	0	0
\$4.00	\$4.25	.75	.40	.15	0	0	0	0	0	0	0	0	0	0
\$4.25	\$4.50	.80	.45	.20	0	0	0	0	0	0	0	0	0	0
\$4.50	\$4.75	.85	.50	.25	0	0	0	0	0	0	0	0	0	0
\$4.75	\$5.00	.90	.55	.30	0	0	0	0	0	0	0	0	0	0
\$5.00	\$5.25	.95	.60	.35	.05	0	0	0	0	0	0	0	0	0
\$5.25	\$5.50	1.00	.65	.40	.10	0	0	0	0	0	0	0	0	0
\$5.50	\$5.75	1.05	.70	.45	.15	0	0	0	0	0	0	0	0	0
\$5.75	\$6.00	1.10	.75	.50	.20	0	0	0	0	0	0	0	0	0
\$6.00	\$6.25	1.15	.80	.55	.25	0	0	0	0	0	0	0	0	0
\$6.25	\$6.50	1.20	.85	.60	.30	0	0	0	0	0	0	0	0	0
\$6.50	\$6.75	1.25	.90	.65	.35	.05	0	0	0	0	0	0	0	0
\$6.75	\$7.00	1.30	.95	.70	.40	.10	0	0	0	0	0	0	0	0
\$7.00	\$7.25	1.35	1.00	.75	.45	.15	0	0	0	0	0	0	0	0
\$7.25	\$7.50	1.40	1.05	.80	.50	.20	0	0	0	0	0	0	0	0
\$7.50	\$7.75	1.45	1.10	.85	.55	.25	0	0	0	0	0	0	0	0
\$7.75	\$8.00	1.50	1.15	.90	.60	.30	.05	0	0	0	0	0	0	0
\$8.00	\$8.25	1.55	1.20	.95	.65	.35	.10	0	0	0	0	0	0	0
\$8.25	\$8.50	1.60	1.25	1.00	.70	.45	.15	0	0	0	0	0	0	0
\$8.50	\$8.75	1.65	1.30	1.05	.75	.50	.20	0	0	0	0	0	0	0
\$8.75	\$9.00	1.70	1.35	1.10	.80	.55	.25	0	0	0	0	0	0	0
\$9.00	\$9.25	1.75	1.40	1.15	.85	.60	.30	.05	0	0	0	0	0	0
\$9.25	\$9.50	1.80	1.45	1.20	.90	.65	.35	.10	0	0	0	0	0	0
\$9.50	\$9.75	1.85	1.50	1.25	.95	.70	.40	.15	0	0	0	0	0	0
\$9.75	\$10.00	1.90	1.55	1.30	1.00	.75	.45	.20	0	0	0	0	0	0
\$10.00	\$10.50	1.95	1.60	1.35	1.05	.80	.50	.25	0	0	0	0	0	0
\$10.50	\$11.00	2.00	1.65	1.40	1.10	.85	.55	.30	.05	0	0	0	0	0
\$11.00	\$11.50	2.05	1.70	1.45	1.15	.90	.60	.35	.10	0	0	0	0	0
\$11.50	\$12.00	2.10	1.75	1.50	1.20	.95	.65	.40	.15	0	0	0	0	0
\$12.00	\$12.50	2.15	1.80	1.55	1.25	1.00	.70	.45	.20	0	0	0	0	0
\$12.50	\$13.00	2.20	1.85	1.60	1.30	1.05	.75	.50	.25	0	0	0	0	0
\$13.00	\$13.50	2.25	1.90	1.65	1.35	1.10	.80	.55	.30	.05	0	0	0	0
\$13.50	\$14.00	2.30	1.95	1.70	1.40	1.15	.85	.60	.35	.10	0	0	0	0
\$14.00	\$14.50	2.35	2.00	1.75	1.45	1.20	.90	.65	.40	.15	0	0	0	0
\$14.50	\$15.00	2.40	2.05	1.80	1.50	1.25	.95	.70	.45	.20	0	0	0	0
\$15.00	\$15.50	2.45	2.10	1.85	1.55	1.30	1.00	.75	.50	.25	0	0	0	0
\$15.50	\$16.00	2.50	2.15	1.90	1.60	1.35	1.05	.80	.55	.30	.05	0	0	0
\$16.00	\$16.50	2.55	2.20	1.95	1.65	1.40	1.10	.85	.60	.35	.10	0	0	0
\$16.50	\$17.00	2.60	2.25	2.00	1.70	1.45	1.15	.90	.65	.40	.15	0	0	0
\$17.00	\$17.50	2.65	2.30	2.05	1.75	1.50	1.20	.95	.70	.45	.20	0	0	0
\$17.50	\$18.00	2.70	2.35	2.10	1.80	1.55	1.25	1.00	.75	.50	.25	0	0	0
\$18.00	\$18.50	2.75	2.40	2.15	1.85	1.60	1.30	1.05	.80	.55	.30	.05	0	0
\$18.50	\$19.00	2.80	2.45	2.20	1.90	1.65	1.35	1.10	.85	.60	.35	.10	0	0
\$19.00	\$19.50	2.85	2.50	2.25	1.95	1.70	1.40	1.15	.90	.65	.40	.15	0	0
\$19.50	\$20.00	2.90	2.55	2.30	2.00	1.75	1.45	1.20	.95	.70	.45	.20	0	0
\$20.00	\$20.50	2.95	2.60	2.35	2.05	1.80	1.50	1.25	1.00	.75	.50	.25	0	0
\$20.50	\$21.00	3.00	2.65	2.40	2.10	1.85	1.55	1.30	1.05	.80	.55	.30	.05	0
\$21.00	\$21.50	3.05	2.70	2.45	2.15	1.90	1.60	1.35	1.10	.85	.60	.35	.10	0
\$21.50	\$22.00	3.10	2.75	2.50	2.20	1.95	1.65	1.40	1.15	.90	.65	.40	.15	0
\$22.00	\$22.50	3.15	2.80	2.55	2.25	2.00	1.70	1.45	1.20	.95	.70	.45	.20	0
\$22.50	\$23.00	3.20	2.85	2.60	2.30	2.05	1.75	1.50	1.25	1.00	.75	.50	.25	0
\$23.00	\$23.50	3.25	2.90	2.65	2.35	2.10	1.80	1.55	1.30	1.05	.80	.55	.30	.05
\$23.50	\$24.00	3.30	2.95	2.70	2.40	2.15	1.85	1.60	1.35	1.10	.85	.60	.35	.10
\$24.00	\$24.50	3.35	3.00	2.75	2.45	2.20	1.90	1.65	1.40	1.15	.90	.65	.40	.15
\$24.50	\$25.00	3.40	3.05	2.80	2.50	2.25	1.95	1.70	1.45	1.20	.95	.70	.45	.20
\$25.00	\$25.50	3.45	3.10	2.85	2.55	2.30	2.00	1.75	1.50	1.25	1.00	.75	.50	.25
\$25.50	\$26.00	3.50	3.15	2.90	2.60	2.35	2.05	1.80	1.55	1.30	1.05	.80	.55	.30
\$26.00	\$26.50	3.55	3.20	2.95	2.65	2.40	2.10	1.85	1.60	1.35	1.10	.85	.60	.35
\$26.50	\$27.00	3.60	3.25	3.00	2.70	2.45	2.15	1.90	1.65	1.40	1.15	.90	.65	.40
\$27.00	\$27.50	3.65	3.30	3.05	2.75	2.50	2.20	1.95	1.70	1.45	1.20	.95	.70	.45
\$27.50	\$28.00	3.70	3.35	3.10	2.80	2.55	2.25	2.00	1.75	1.50	1.25	1.00	.75	.50
\$28.00	\$28.50	3.75	3.40	3.15	2.85	2.60	2.30	2.05	1.80	1.55	1.30	1.05	.80	.55
\$28.50	\$29.00	3.80	3.45	3.20	2.90	2.65	2.35	2.10	1.85	1.60	1.35	1.10	.85	.60
\$29.00	\$30.00	3.85	3.50	3.25	2.95	2.70	2.40	2.15	1.90	1.65	1.40	1.15	.90	.65
\$30.00		3.90	3.55	3.30	3.00	2.75	2.45	2.20	1.95	1.70	1.45	1.20	.95	.70
<b>15 percent of the excess over \$30 plus—</b>														
\$30 and over		4.80	4.25	3.95	3.70	3.40	3.15	2.85	2.60	2.30	2.05	1.75		

**"(B) WAGES PAID AFTER DECEMBER 31, 1964.**—At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee after December 31, 1964, a tax determined in accordance with the following tables, which shall be in lieu of the tax required to be deducted and withheld under subsection (a) :

"If the payroll period with respect to an employee is weekly—

And the wages are—		And the number of withholding exemptions claimed to—											
At least—	But less than—												
		0	1	2	3	4	5	6	7	8	9	10 or more	
		The amount of income tax to be withheld shall be—											
\$0.....	\$13.....	14% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$13.....	\$14.....	\$1.00	.10	0	0	0	0	0	0	0	0	0	0
\$14.....	\$15.....	2.00	.20	0	0	0	0	0	0	0	0	0	0
\$15.....	\$16.....	2.20	.40	0	0	0	0	0	0	0	0	0	0
\$16.....	\$17.....	2.30	.60	0	0	0	0	0	0	0	0	0	0
\$17.....	\$18.....	2.60	.70	0	0	0	0	0	0	0	0	0	0
\$18.....	\$19.....	2.60	.80	0	0	0	0	0	0	0	0	0	0
\$19.....	\$20.....	2.70	.90	0	0	0	0	0	0	0	0	0	0
\$20.....	\$21.....	2.80	1.10	0	0	0	0	0	0	0	0	0	0
\$21.....	\$22.....	3.00	1.20	0	0	0	0	0	0	0	0	0	0
\$22.....	\$23.....	3.20	1.40	0	0	0	0	0	0	0	0	0	0
\$23.....	\$24.....	3.30	1.60	0	0	0	0	0	0	0	0	0	0
\$24.....	\$25.....	3.40	1.60	0	0	0	0	0	0	0	0	0	0
\$25.....	\$26.....	3.60	1.80	0	0	0	0	0	0	0	0	0	0
\$26.....	\$27.....	3.70	1.80	.10	0	0	0	0	0	0	0	0	0
\$27.....	\$28.....	3.60	2.10	.30	0	0	0	0	0	0	0	0	0
\$28.....	\$29.....	4.00	2.20	.40	0	0	0	0	0	0	0	0	0
\$29.....	\$30.....	4.10	2.30	.60	0	0	0	0	0	0	0	0	0
\$30.....	\$31.....	4.30	2.60	.70	0	0	0	0	0	0	0	0	0
\$31.....	\$32.....	4.40	2.60	.80	0	0	0	0	0	0	0	0	0
\$32.....	\$33.....	4.60	2.80	1.00	0	0	0	0	0	0	0	0	0
\$33.....	\$34.....	4.70	2.80	1.10	0	0	0	0	0	0	0	0	0
\$34.....	\$35.....	4.80	3.00	1.20	0	0	0	0	0	0	0	0	0
\$35.....	\$36.....	5.00	3.20	1.40	0	0	0	0	0	0	0	0	0
\$36.....	\$37.....	5.10	3.30	1.60	0	0	0	0	0	0	0	0	0
\$37.....	\$38.....	5.30	3.60	1.70	0	0	0	0	0	0	0	0	0
\$38.....	\$39.....	5.40	3.60	1.80	0	0	0	0	0	0	0	0	0
\$39.....	\$40.....	5.60	3.70	1.90	.10	0	0	0	0	0	0	0	0
\$40.....	\$41.....	5.70	3.70	2.10	.30	0	0	0	0	0	0	0	0
\$41.....	\$42.....	5.80	4.00	2.20	.40	0	0	0	0	0	0	0	0
\$42.....	\$43.....	6.00	4.20	2.40	.60	0	0	0	0	0	0	0	0
\$43.....	\$44.....	6.10	4.20	2.60	.70	0	0	0	0	0	0	0	0
\$44.....	\$45.....	6.20	4.40	2.60	.80	0	0	0	0	0	0	0	0
\$45.....	\$46.....	6.40	4.60	2.80	1.00	0	0	0	0	0	0	0	0
\$46.....	\$47.....	6.60	4.70	2.90	1.10	0	0	0	0	0	0	0	0
\$47.....	\$48.....	6.70	4.70	3.10	1.30	0	0	0	0	0	0	0	0
\$48.....	\$49.....	6.80	5.00	3.20	1.40	0	0	0	0	0	0	0	0
\$49.....	\$50.....	6.90	5.10	3.30	1.60	0	0	0	0	0	0	0	0
\$50.....	\$51.....	7.10	5.30	3.60	1.70	0	0	0	0	0	0	0	0
\$51.....	\$52.....	7.20	5.40	3.60	1.80	0	0	0	0	0	0	0	0
\$52.....	\$53.....	7.40	5.60	3.70	2.00	.20	0	0	0	0	0	0	0
\$53.....	\$54.....	7.60	5.70	3.90	2.10	.30	0	0	0	0	0	0	0
\$54.....	\$55.....	7.60	5.80	4.00	2.20	.60	0	0	0	0	0	0	0
\$55.....	\$56.....	7.80	6.00	4.20	2.40	.60	0	0	0	0	0	0	0

"If the payroll period with respect to an employee is weekly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$56	\$57	\$7.00	\$0.10	\$4.30	\$2.50	\$7.70	\$0	\$0	\$0	\$0	\$0	\$0
\$57	\$58	8.10	0.30	4.60	2.70	1.00	0	0	0	0	0	0
\$58	\$59	8.20	0.40	4.60	2.80	1.00	0	0	0	0	0	0
\$59	\$60	8.30	0.50	4.70	2.90	1.20	0	0	0	0	0	0
\$60	\$62	8.50	0.70	5.00	3.20	1.40	0	0	0	0	0	0
\$62	\$61	8.80	7.00	5.20	3.40	1.60	0	0	0	0	0	0
\$61	\$65	9.10	7.30	5.50	3.70	1.90	.10	0	0	0	0	0
\$65	\$68	9.40	7.60	5.80	4.00	2.20	.40	0	0	0	0	0
\$68	\$70	9.70	7.90	6.10	4.30	2.50	.70	0	0	0	0	0
\$70	\$72	9.90	8.10	6.40	4.60	2.80	1.00	0	0	0	0	0
\$72	\$74	10.20	8.40	6.70	4.90	3.10	1.20	0	0	0	0	0
\$74	\$76	10.50	8.70	7.00	5.10	3.30	1.50	0	0	0	0	0
\$76	\$78	10.80	9.00	7.20	5.40	3.60	1.80	0	0	0	0	0
\$78	\$80	11.10	9.30	7.50	5.70	3.90	2.10	.20	0	0	0	0
\$80	\$82	11.30	9.50	7.80	6.00	4.20	2.40	.60	0	0	0	0
\$82	\$84	11.60	9.80	8.00	6.20	4.40	2.60	.90	0	0	0	0
\$84	\$86	11.90	10.10	8.30	6.50	4.70	2.90	1.10	0	0	0	0
\$86	\$88	12.20	10.40	8.60	6.80	5.00	3.20	1.40	0	0	0	0
\$88	\$90	12.60	10.70	8.90	7.10	5.30	3.50	1.70	0	0	0	0
\$90	\$92	12.70	10.90	9.20	7.40	5.60	3.80	2.00	.20	0	0	0
\$92	\$94	13.00	11.20	9.40	7.60	5.80	4.00	2.30	.50	0	0	0
\$94	\$96	13.30	11.50	9.70	7.90	6.10	4.30	2.60	.70	0	0	0
\$96	\$98	13.60	11.80	10.00	8.20	6.40	4.60	2.80	1.00	0	0	0
\$98	\$100	13.90	12.10	10.30	8.50	6.70	4.90	3.10	1.30	0	0	0
\$100	\$105	14.40	12.60	10.80	9.00	7.20	5.40	3.60	1.80	0	0	0
\$105	\$110	15.10	13.30	11.50	9.70	7.90	6.10	4.30	2.50	.70	0	0
\$110	\$115	15.80	14.00	12.20	10.40	8.60	6.80	5.00	3.20	1.40	0	0
\$115	\$120	16.50	14.70	12.90	11.10	9.30	7.50	5.70	3.90	2.10	.30	0
\$120	\$125	17.20	15.40	13.60	11.80	10.00	8.20	6.40	4.60	2.80	1.00	0
\$125	\$130	17.90	16.10	14.30	12.50	10.70	8.90	7.10	5.30	3.50	1.70	0
\$130	\$135	18.60	16.80	15.00	13.20	11.40	9.60	7.80	6.00	4.20	2.40	.60
\$135	\$140	19.30	17.50	15.70	13.90	12.10	10.30	8.50	6.70	4.90	3.10	1.30
\$140	\$145	20.00	18.20	16.40	14.60	12.80	11.00	9.20	7.40	5.60	3.80	2.00
\$145	\$150	20.70	18.90	17.10	15.30	13.50	11.70	9.90	8.10	6.30	4.50	2.70
\$150	\$160	21.70	19.90	18.10	16.30	14.50	12.70	10.90	9.10	7.30	5.50	3.80
\$160	\$170	23.10	21.30	19.50	17.70	15.90	14.10	12.30	10.50	8.70	6.90	5.20
\$170	\$180	24.60	22.70	20.90	19.10	17.30	15.50	13.70	11.90	10.10	8.30	6.60
\$180	\$190	25.60	24.10	22.30	20.50	18.70	16.90	15.10	13.30	11.50	9.70	8.00
\$190	\$200	27.30	25.50	23.70	21.90	20.10	18.30	16.50	14.70	12.90	11.10	9.40
14 percent of the excess over \$200 plus—												
\$200 and over		28.00	26.20	24.40	22.60	20.80	19.00	17.20	15.40	13.60	11.80	10.10

"If the payroll period with respect to an employee is biweekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
The amount of income tax to be withheld shall be—												
\$0.....	\$26.....	14% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$26.....	\$28.....	\$3.80	.20	0	0	0	0	0	0	0	0	0
\$28.....	\$30.....	4.10	.50	0	0	0	0	0	0	0	0	0
\$30.....	\$32.....	4.30	.80	0	0	0	0	0	0	0	0	0
\$32.....	\$34.....	4.60	1.00	0	0	0	0	0	0	0	0	0
\$34.....	\$36.....	4.90	1.30	0	0	0	0	0	0	0	0	0
\$36.....	\$38.....	5.20	1.00	0	0	0	0	0	0	0	0	0
\$38.....	\$40.....	5.50	1.00	0	0	0	0	0	0	0	0	0
\$40.....	\$42.....	5.70	2.20	0	0	0	0	0	0	0	0	0
\$42.....	\$44.....	6.00	2.40	0	0	0	0	0	0	0	0	0
\$44.....	\$46.....	6.30	2.70	0	0	0	0	0	0	0	0	0
\$46.....	\$48.....	6.60	3.00	0	0	0	0	0	0	0	0	0
\$48.....	\$50.....	6.90	3.30	0	0	0	0	0	0	0	0	0
\$50.....	\$52.....	7.10	3.60	0	0	0	0	0	0	0	0	0
\$52.....	\$54.....	7.40	3.80	.20	0	0	0	0	0	0	0	0
\$54.....	\$56.....	7.70	4.10	.50	0	0	0	0	0	0	0	0
\$56.....	\$58.....	8.00	4.40	.80	0	0	0	0	0	0	0	0
\$58.....	\$60.....	8.30	4.70	1.10	0	0	0	0	0	0	0	0
\$60.....	\$62.....	8.50	5.00	1.40	0	0	0	0	0	0	0	0
\$62.....	\$64.....	8.80	5.20	1.60	0	0	0	0	0	0	0	0
\$64.....	\$66.....	9.10	5.50	1.90	0	0	0	0	0	0	0	0
\$66.....	\$68.....	9.40	5.80	2.20	0	0	0	0	0	0	0	0
\$68.....	\$70.....	9.70	6.10	2.50	0	0	0	0	0	0	0	0
\$70.....	\$72.....	9.90	6.40	2.80	0	0	0	0	0	0	0	0
\$72.....	\$74.....	10.20	6.60	3.00	0	0	0	0	0	0	0	0
\$74.....	\$76.....	10.50	6.90	3.30	0	0	0	0	0	0	0	0
\$76.....	\$78.....	10.80	7.20	3.60	0	0	0	0	0	0	0	0
\$78.....	\$80.....	11.10	7.50	3.90	.30	0	0	0	0	0	0	0
\$80.....	\$82.....	11.30	7.80	4.20	.60	0	0	0	0	0	0	0
\$82.....	\$84.....	11.60	8.00	4.40	.90	0	0	0	0	0	0	0
\$84.....	\$86.....	11.90	8.30	4.70	1.10	0	0	0	0	0	0	0
\$86.....	\$88.....	12.20	8.60	5.00	1.40	0	0	0	0	0	0	0
\$88.....	\$90.....	12.50	8.90	5.30	1.70	0	0	0	0	0	0	0
\$90.....	\$92.....	12.70	9.20	5.60	2.00	0	0	0	0	0	0	0
\$92.....	\$94.....	13.00	9.40	5.80	2.30	0	0	0	0	0	0	0
\$94.....	\$96.....	13.30	9.70	6.10	2.60	0	0	0	0	0	0	0
\$96.....	\$98.....	13.60	10.00	6.40	2.80	0	0	0	0	0	0	0
\$98.....	\$100.....	13.90	10.30	6.70	3.10	0	0	0	0	0	0	0
\$100.....	\$102.....	14.10	10.60	7.00	3.40	0	0	0	0	0	0	0
\$102.....	\$104.....	14.40	10.80	7.20	3.70	.10	0	0	0	0	0	0
\$104.....	\$106.....	14.70	11.10	7.50	3.90	.30	0	0	0	0	0	0
\$106.....	\$108.....	15.00	11.40	7.80	4.20	.60	0	0	0	0	0	0
\$108.....	\$110.....	15.30	11.70	8.10	4.50	.90	0	0	0	0	0	0
\$110.....	\$112.....	15.50	12.00	8.40	4.80	1.20	0	0	0	0	0	0
\$112.....	\$114.....	15.80	12.20	8.60	5.10	1.50	0	0	0	0	0	0



"If the payroll period with respect to an employee is biweekly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$114	\$116	\$16.10	\$12.50	\$8.00	\$5.30	\$1.70	\$0	\$0	\$0	\$0	\$0	\$0
\$116	\$118	16.40	12.80	9.20	5.60	2.00	0	0	0	0	0	0
\$118	\$120	16.70	13.10	9.50	5.90	2.30	0	0	0	0	0	0
\$120	\$124	17.10	13.50	9.90	6.30	2.70	0	0	0	0	0	0
\$124	\$128	17.60	14.10	10.50	6.90	3.30	0	0	0	0	0	0
\$128	\$132	18.20	14.60	11.00	7.40	3.80	.30	0	0	0	0	0
\$132	\$136	18.80	15.20	11.60	8.00	4.40	.60	0	0	0	0	0
\$136	\$140	19.50	15.70	12.10	8.60	5.00	1.40	0	0	0	0	0
\$140	\$144	19.90	16.30	12.70	9.10	5.50	1.90	0	0	0	0	0
\$144	\$148	20.40	16.90	13.30	9.70	6.10	2.50	0	0	0	0	0
\$148	\$152	21.00	17.40	13.80	10.20	6.60	3.10	0	0	0	0	0
\$152	\$156	21.60	18.00	14.40	10.80	7.20	3.60	0	0	0	0	0
\$156	\$160	22.10	18.50	14.90	11.40	7.80	4.20	.60	0	0	0	0
\$160	\$164	22.70	19.10	15.50	11.90	8.30	4.70	1.10	0	0	0	0
\$164	\$168	23.20	19.70	16.10	12.50	8.90	5.30	1.70	0	0	0	0
\$168	\$172	23.80	20.20	16.60	13.00	9.40	5.90	2.30	0	0	0	0
\$172	\$176	24.40	20.80	17.20	13.60	10.00	6.40	2.80	0	0	0	0
\$176	\$180	24.90	21.30	17.70	14.20	10.60	7.00	3.40	0	0	0	0
\$180	\$184	25.60	21.90	18.30	14.70	11.10	7.60	3.90	.40	0	0	0
\$184	\$188	26.00	22.60	18.90	15.30	11.70	8.10	4.50	.90	0	0	0
\$188	\$192	26.60	23.00	19.40	15.80	12.20	8.70	5.10	1.50	0	0	0
\$192	\$196	27.20	23.60	20.00	16.40	12.80	9.20	5.60	2.00	0	0	0
\$196	\$200	27.70	24.10	20.50	17.00	13.40	9.80	6.20	2.60	0	0	0
\$200	\$210	28.70	25.10	21.50	17.90	14.30	10.80	7.20	3.60	0	0	0
\$210	\$220	30.10	26.50	22.90	19.30	15.70	12.20	8.60	5.00	1.40	0	0
\$220	\$230	31.60	27.90	24.30	20.70	17.10	13.60	10.00	6.40	2.80	0	0
\$230	\$240	32.90	29.30	25.70	22.10	18.60	15.00	11.40	7.80	4.20	.60	0
\$240	\$250	34.30	30.70	27.10	23.50	19.90	16.40	12.80	9.20	5.60	2.00	0
\$250	\$260	35.70	32.10	28.50	24.90	21.30	17.80	14.20	10.60	7.00	3.40	0
\$260	\$270	37.10	33.50	29.90	26.30	22.70	19.20	15.60	12.00	8.40	4.80	1.20
\$270	\$280	38.60	34.90	31.30	27.70	24.10	20.60	17.00	13.40	9.80	6.20	2.60
\$280	\$290	39.90	36.30	32.70	29.10	25.50	22.00	18.40	14.80	11.20	7.60	4.00
\$290	\$300	41.30	37.70	34.10	30.60	26.90	23.40	19.80	16.20	12.60	9.00	5.40
\$300	\$320	43.40	39.80	36.20	32.60	29.00	25.60	21.90	18.30	14.70	11.10	7.50
\$320	\$340	46.20	42.60	39.00	35.40	31.80	28.30	24.70	21.10	17.50	13.90	10.30
\$340	\$360	49.00	45.40	41.80	38.20	34.60	31.10	27.50	23.90	20.30	16.70	13.10
\$360	\$380	51.80	48.20	44.60	41.00	37.40	33.90	30.30	26.70	23.10	19.60	15.90
\$380	\$400	54.60	51.00	47.40	43.80	40.20	36.70	33.10	29.50	25.90	22.30	18.70
14 percent of the excess over \$400 plus—												
\$400 and over		56.00	52.40	48.80	45.20	41.60	38.10	34.50	30.90	27.30	23.70	20.10

"If the payroll period with respect to an employee is semimonthly—

And the wages are—		And the number of withholding exemptions claimed to—											
At least—	But less than—	14% of wages	0	1	2	3	4	5	6	7	8	9	10 or more
			The amount of income tax to be withheld shall be—										
\$0.....	\$28.....	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$28.....	\$30.....	\$4.10	.20	0	0	0	0	0	0	0	0	0	0
\$30.....	\$32.....	4.30	.50	0	0	0	0	0	0	0	0	0	0
\$32.....	\$34.....	4.60	.70	0	0	0	0	0	0	0	0	0	0
\$34.....	\$36.....	4.90	1.00	0	0	0	0	0	0	0	0	0	0
\$36.....	\$38.....	5.20	1.30	0	0	0	0	0	0	0	0	0	0
\$38.....	\$40.....	5.50	1.60	0	0	0	0	0	0	0	0	0	0
\$40.....	\$42.....	5.70	1.90	0	0	0	0	0	0	0	0	0	0
\$42.....	\$44.....	6.00	2.10	0	0	0	0	0	0	0	0	0	0
\$44.....	\$46.....	6.30	2.40	0	0	0	0	0	0	0	0	0	0
\$46.....	\$48.....	6.60	2.70	0	0	0	0	0	0	0	0	0	0
\$48.....	\$50.....	6.90	3.00	0	0	0	0	0	0	0	0	0	0
\$50.....	\$52.....	7.10	3.30	0	0	0	0	0	0	0	0	0	0
\$52.....	\$54.....	7.40	3.60	0	0	0	0	0	0	0	0	0	0
\$54.....	\$56.....	7.70	3.90	0	0	0	0	0	0	0	0	0	0
\$56.....	\$58.....	8.00	4.10	.20	0	0	0	0	0	0	0	0	0
\$58.....	\$60.....	8.30	4.40	.50	0	0	0	0	0	0	0	0	0
\$60.....	\$62.....	8.60	4.70	.80	0	0	0	0	0	0	0	0	0
\$62.....	\$64.....	8.80	4.90	1.00	0	0	0	0	0	0	0	0	0
\$64.....	\$66.....	9.10	5.20	1.30	0	0	0	0	0	0	0	0	0
\$66.....	\$68.....	9.40	5.50	1.60	0	0	0	0	0	0	0	0	0
\$68.....	\$70.....	9.70	5.80	1.90	0	0	0	0	0	0	0	0	0
\$70.....	\$72.....	9.90	6.10	2.20	0	0	0	0	0	0	0	0	0
\$72.....	\$74.....	10.20	6.30	2.40	0	0	0	0	0	0	0	0	0
\$74.....	\$76.....	10.50	6.60	2.70	0	0	0	0	0	0	0	0	0
\$76.....	\$78.....	10.80	6.90	3.00	0	0	0	0	0	0	0	0	0
\$78.....	\$80.....	11.10	7.20	3.30	0	0	0	0	0	0	0	0	0
\$80.....	\$82.....	11.30	7.50	3.60	0	0	0	0	0	0	0	0	0
\$82.....	\$84.....	11.60	7.70	3.80	0	0	0	0	0	0	0	0	0
\$84.....	\$86.....	11.90	8.00	4.10	.20	0	0	0	0	0	0	0	0
\$86.....	\$88.....	12.20	8.30	4.40	.50	0	0	0	0	0	0	0	0
\$88.....	\$90.....	12.50	8.60	4.70	.80	0	0	0	0	0	0	0	0
\$90.....	\$92.....	12.70	8.90	5.00	1.10	0	0	0	0	0	0	0	0
\$92.....	\$94.....	13.00	9.10	5.20	1.40	0	0	0	0	0	0	0	0
\$94.....	\$96.....	13.30	9.40	5.50	1.60	0	0	0	0	0	0	0	0
\$96.....	\$98.....	13.60	9.70	5.80	1.90	0	0	0	0	0	0	0	0
\$98.....	\$100.....	13.90	10.00	6.10	2.20	0	0	0	0	0	0	0	0
\$100.....	\$102.....	14.10	10.30	6.40	2.50	0	0	0	0	0	0	0	0
\$102.....	\$104.....	14.40	10.50	6.60	2.80	0	0	0	0	0	0	0	0
\$104.....	\$106.....	14.70	10.80	6.90	3.00	0	0	0	0	0	0	0	0
\$106.....	\$108.....	15.00	11.10	7.20	3.30	0	0	0	0	0	0	0	0
\$108.....	\$110.....	15.30	11.40	7.50	3.60	0	0	0	0	0	0	0	0
\$110.....	\$112.....	15.60	11.70	7.80	3.90	0	0	0	0	0	0	0	0
\$112.....	\$114.....	15.80	11.90	8.00	4.20	.30	0	0	0	0	0	0	0

"If the payroll period with respect to an employe is semimonthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$114.....	\$110.....	\$10.10	\$12.20	\$8.30	\$4.40	\$5.50	\$0	\$0	\$0	\$0	\$0	\$0
\$116.....	\$118.....	10.40	12.60	8.60	4.70	5.80	0	0	0	0	0	0
\$118.....	\$120.....	10.70	12.80	8.80	5.00	6.10	0	0	0	0	0	0
\$120.....	\$124.....	17.10	13.20	9.30	5.40	6.50	0	0	0	0	0	0
\$124.....	\$128.....	17.60	13.80	9.60	6.00	7.10	0	0	0	0	0	0
\$128.....	\$132.....	18.20	14.30	10.40	6.70	7.80	0	0	0	0	0	0
\$132.....	\$136.....	18.80	14.60	11.00	7.10	8.20	0	0	0	0	0	0
\$136.....	\$140.....	19.30	15.40	11.60	7.70	8.80	0	0	0	0	0	0
\$140.....	\$144.....	19.60	16.00	12.10	8.20	9.30	0.40	0	0	0	0	0
\$144.....	\$148.....	20.40	16.60	12.70	8.80	9.90	1.00	0	0	0	0	0
\$148.....	\$152.....	21.00	17.10	13.20	9.30	10.40	1.60	0	0	0	0	0
\$152.....	\$156.....	21.60	17.70	13.80	9.90	11.00	2.10	0	0	0	0	0
\$156.....	\$160.....	22.10	18.20	14.30	10.50	11.60	2.70	0	0	0	0	0
\$160.....	\$164.....	22.70	18.80	14.60	11.00	12.10	3.20	0	0	0	0	0
\$164.....	\$168.....	23.20	19.40	15.50	11.60	12.70	3.80	0	0	0	0	0
\$168.....	\$172.....	23.80	19.90	16.00	12.10	13.20	4.40	.50	0	0	0	0
\$172.....	\$176.....	24.40	20.60	16.60	12.70	13.80	5.00	1.00	0	0	0	0
\$176.....	\$180.....	24.60	21.00	17.10	13.30	14.40	5.50	1.60	0	0	0	0
\$180.....	\$184.....	25.60	21.60	17.70	13.80	15.00	6.00	2.10	0	0	0	0
\$184.....	\$188.....	26.00	22.20	18.30	14.40	15.60	6.60	2.70	0	0	0	0
\$188.....	\$192.....	26.60	22.70	18.80	14.60	16.10	7.20	3.30	0	0	0	0
\$192.....	\$196.....	27.20	23.30	19.40	15.50	16.70	7.70	3.80	0	0	0	0
\$196.....	\$200.....	27.70	23.80	19.90	16.00	17.20	8.30	4.40	.50	0	0	0
\$200.....	\$210.....	28.70	24.80	20.90	17.00	18.10	9.30	5.40	1.50	0	0	0
\$210.....	\$220.....	30.10	26.20	22.30	18.40	19.40	10.70	6.80	2.90	0	0	0
\$220.....	\$230.....	31.60	27.60	23.70	19.80	20.70	12.10	8.20	4.30	.40	0	0
\$230.....	\$240.....	32.60	29.00	25.10	21.20	22.00	13.50	9.60	5.70	1.80	0	0
\$240.....	\$250.....	34.30	30.40	26.60	22.60	23.40	14.60	11.00	7.10	3.20	0	0
\$250.....	\$260.....	35.70	31.80	27.60	24.00	24.80	16.00	12.40	8.50	4.60	.70	0
\$260.....	\$270.....	37.10	33.20	29.30	25.40	26.20	17.40	13.80	9.90	6.00	2.10	0
\$270.....	\$280.....	38.60	34.60	30.70	26.80	27.60	18.80	15.20	11.30	7.40	3.50	0
\$280.....	\$290.....	39.60	36.00	32.10	28.20	29.00	20.20	16.60	12.70	8.80	4.90	1.00
\$290.....	\$300.....	41.30	37.40	33.60	29.60	30.40	21.60	18.00	14.10	10.20	6.30	2.40
\$300.....	\$320.....	43.40	39.60	35.60	31.70	32.60	24.00	20.10	16.20	12.30	8.40	4.50
\$320.....	\$340.....	46.20	42.30	38.40	34.70	35.40	26.60	22.60	19.00	15.10	11.20	7.30
\$340.....	\$360.....	49.00	45.10	41.20	37.30	38.20	30.00	25.70	21.80	17.60	14.00	10.10
\$360.....	\$380.....	51.80	47.60	44.00	40.10	41.00	32.40	28.70	24.60	20.70	16.80	12.90
\$380.....	\$400.....	54.60	50.70	46.80	42.60	43.80	35.20	31.30	27.40	23.60	19.60	15.70
\$400.....	\$420.....	57.40	53.60	49.60	45.70	46.60	38.00	34.10	30.20	26.30	22.40	18.60
\$420.....	\$440.....	60.20	56.30	52.40	48.70	49.40	40.80	36.90	33.00	29.10	25.20	21.30
\$440.....	\$460.....	63.00	59.10	55.20	51.30	52.20	43.60	39.70	35.80	31.90	28.00	24.10
\$460.....	\$480.....	65.80	61.00	58.00	54.10	55.00	46.40	42.50	38.60	34.70	30.80	26.60
\$480.....	\$500.....	68.60	64.70	60.80	56.00	57.00	49.20	45.30	41.40	37.60	33.60	29.70
		14 percent of the excess over \$500 plus—										
\$500 and over.....		70.00	66.10	62.20	58.30	54.40	50.60	46.70	42.80	38.90	35.00	31.10

"If the payroll period with respect to an employee is monthly—

And the wages are—		And the number of withholding exemptions claimed is—											
At least—	But less than—	The amount of income tax to be withheld shall be—											
		0	1	2	3	4	5	6	7	8	9	10 or more	
\$0.....	\$50.....	14% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$50.....	\$60.....	\$8.10	.30	0	0	0	0	0	0	0	0	0	0
\$60.....	\$64.....	8.70	.90	0	0	0	0	0	0	0	0	0	0
\$64.....	\$68.....	9.20	1.50	0	0	0	0	0	0	0	0	0	0
\$68.....	\$72.....	9.80	2.00	0	0	0	0	0	0	0	0	0	0
\$72.....	\$76.....	10.40	2.60	0	0	0	0	0	0	0	0	0	0
\$76.....	\$80.....	10.90	3.10	0	0	0	0	0	0	0	0	0	0
\$80.....	\$84.....	11.50	3.70	0	0	0	0	0	0	0	0	0	0
\$84.....	\$88.....	12.00	4.30	0	0	0	0	0	0	0	0	0	0
\$88.....	\$92.....	12.60	4.80	0	0	0	0	0	0	0	0	0	0
\$92.....	\$96.....	13.20	5.40	0	0	0	0	0	0	0	0	0	0
\$96.....	\$100.....	13.70	5.90	0	0	0	0	0	0	0	0	0	0
\$100.....	\$104.....	14.30	6.50	0	0	0	0	0	0	0	0	0	0
\$104.....	\$108.....	14.80	7.10	0	0	0	0	0	0	0	0	0	0
\$108.....	\$112.....	15.40	7.60	0	0	0	0	0	0	0	0	0	0
\$112.....	\$116.....	16.00	8.20	.40	0	0	0	0	0	0	0	0	0
\$116.....	\$120.....	16.50	8.70	1.00	0	0	0	0	0	0	0	0	0
\$120.....	\$124.....	17.10	9.30	1.50	0	0	0	0	0	0	0	0	0
\$124.....	\$128.....	17.60	9.90	2.10	0	0	0	0	0	0	0	0	0
\$128.....	\$132.....	18.20	10.40	2.60	0	0	0	0	0	0	0	0	0
\$132.....	\$136.....	18.80	11.00	3.20	0	0	0	0	0	0	0	0	0
\$136.....	\$140.....	19.30	11.50	3.80	0	0	0	0	0	0	0	0	0
\$140.....	\$144.....	19.90	12.10	4.30	0	0	0	0	0	0	0	0	0
\$144.....	\$148.....	20.40	12.70	4.90	0	0	0	0	0	0	0	0	0
\$148.....	\$152.....	21.00	13.20	5.40	0	0	0	0	0	0	0	0	0
\$152.....	\$156.....	21.60	13.80	6.00	0	0	0	0	0	0	0	0	0
\$156.....	\$160.....	22.10	14.30	6.60	0	0	0	0	0	0	0	0	0
\$160.....	\$164.....	22.70	14.90	7.10	0	0	0	0	0	0	0	0	0
\$164.....	\$168.....	23.20	15.50	7.70	0	0	0	0	0	0	0	0	0
\$168.....	\$172.....	23.80	16.00	8.20	.50	0	0	0	0	0	0	0	0
\$172.....	\$176.....	24.40	16.60	8.80	1.00	0	0	0	0	0	0	0	0
\$176.....	\$180.....	24.90	17.10	9.40	1.60	0	0	0	0	0	0	0	0
\$180.....	\$184.....	25.50	17.70	9.90	2.10	0	0	0	0	0	0	0	0
\$184.....	\$188.....	26.00	18.30	10.50	2.70	0	0	0	0	0	0	0	0
\$188.....	\$192.....	26.60	18.80	11.00	3.30	0	0	0	0	0	0	0	0
\$192.....	\$196.....	27.20	19.40	11.60	3.80	0	0	0	0	0	0	0	0
\$196.....	\$200.....	27.70	19.90	12.20	4.40	0	0	0	0	0	0	0	0
\$200.....	\$204.....	28.30	20.50	12.70	4.90	0	0	0	0	0	0	0	0
\$204.....	\$208.....	28.80	21.10	13.30	5.50	0	0	0	0	0	0	0	0
\$208.....	\$212.....	29.40	21.60	13.80	6.10	0	0	0	0	0	0	0	0
\$212.....	\$216.....	30.00	22.20	14.40	6.60	0	0	0	0	0	0	0	0
\$216.....	\$220.....	30.60	22.70	15.00	7.20	0	0	0	0	0	0	0	0
\$220.....	\$224.....	31.10	23.30	15.50	7.70	0	0	0	0	0	0	0	0
\$224.....	\$228.....	31.60	23.90	16.10	8.30	.50	0	0	0	0	0	0	0

"If the payroll period with respect to an employee is monthly—Continued

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
\$228	\$232	\$32.20	\$24.40	\$16.00	\$8.00	\$1.10	\$0	\$0	\$0	\$0	\$0	\$0
\$232	\$236	32.80	25.00	17.20	9.40	1.60	0	0	0	0	0	0
\$236	\$240	33.30	25.50	17.80	10.00	2.20	0	0	0	0	0	0
\$240	\$248	31.20	20.40	18.00	10.80	3.00	0	0	0	0	0	0
\$248	\$256	35.30	27.60	19.70	11.00	4.20	0	0	0	0	0	0
\$256	\$264	36.40	28.00	20.80	13.10	5.30	0	0	0	0	0	0
\$264	\$272	37.50	29.70	22.00	14.20	6.40	0	0	0	0	0	0
\$272	\$280	34.60	30.90	23.10	15.30	7.50	0	0	0	0	0	0
\$280	\$288	39.80	32.00	24.20	16.40	8.60	.00	0	0	0	0	0
\$288	\$296	40.90	33.10	25.30	17.50	9.80	2.00	0	0	0	0	0
\$296	\$304	42.00	31.20	26.40	18.70	10.90	3.10	0	0	0	0	0
\$304	\$312	43.10	35.30	27.60	19.80	12.00	4.20	0	0	0	0	0
\$312	\$320	44.20	30.50	28.70	20.90	13.10	5.40	0	0	0	0	0
\$320	\$328	45.40	37.60	29.80	22.00	14.20	6.50	0	0	0	0	0
\$328	\$336	46.50	38.70	30.90	23.10	15.40	7.70	0	0	0	0	0
\$336	\$344	47.60	39.80	32.00	24.30	16.50	8.70	.00	0	0	0	0
\$344	\$352	48.70	40.90	33.20	25.40	17.60	9.80	2.10	0	0	0	0
\$352	\$360	49.80	42.10	31.30	26.50	18.70	11.00	3.20	0	0	0	0
\$360	\$368	51.00	43.20	35.40	27.60	19.80	12.10	4.30	0	0	0	0
\$368	\$376	52.10	44.30	36.50	28.70	21.00	13.20	5.40	0	0	0	0
\$376	\$384	53.20	45.40	37.60	29.80	22.10	14.30	6.50	0	0	0	0
\$384	\$392	54.30	46.50	38.80	31.00	23.20	15.40	7.70	0	0	0	0
\$392	\$400	55.40	47.70	39.90	32.10	24.30	16.60	8.80	1.00	0	0	0
\$400	\$420	57.40	49.60	41.80	34.10	26.30	18.60	10.70	3.00	0	0	0
\$420	\$440	60.20	52.40	44.60	36.90	29.10	21.30	13.50	5.80	0	0	0
\$440	\$460	63.00	55.20	47.40	39.70	31.90	24.10	16.30	8.60	.80	0	0
\$460	\$480	65.80	58.00	50.20	42.50	34.70	26.90	19.10	11.40	3.60	0	0
\$480	\$500	68.60	60.80	53.00	45.30	37.50	29.70	21.90	14.20	6.40	0	0
\$500	\$520	71.40	63.60	55.80	48.10	40.30	32.60	24.70	17.00	9.20	1.40	0
\$520	\$540	74.20	66.40	58.60	50.90	43.10	35.30	27.50	19.80	12.00	4.20	0
\$540	\$560	77.00	69.20	61.40	53.70	45.90	38.10	30.30	22.60	14.80	7.00	0
\$560	\$580	79.80	72.00	64.20	56.50	48.70	40.90	33.10	25.40	17.60	9.80	2.00
\$580	\$600	82.60	74.80	67.00	59.30	51.50	43.70	35.90	28.20	20.40	12.60	4.80
\$600	\$610	86.80	70.00	71.20	63.50	55.70	47.90	40.10	32.40	24.60	16.80	9.00
\$610	\$680	92.40	84.60	76.80	69.10	61.30	53.60	45.70	38.00	30.20	22.40	14.60
\$680	\$720	98.00	90.20	82.40	74.70	66.90	59.10	51.30	43.60	35.80	28.00	20.20
\$720	\$760	103.60	95.80	88.00	80.30	72.60	64.70	56.90	49.20	41.40	33.60	25.80
\$760	\$800	109.20	101.40	93.60	85.90	78.10	70.30	62.60	54.80	47.00	39.20	31.40
\$800	\$840	114.80	107.00	99.20	91.50	83.70	75.90	68.10	60.40	52.60	44.80	37.00
\$840	\$880	120.40	112.60	104.80	97.10	89.30	81.60	73.70	66.00	58.20	50.40	42.60
\$880	\$920	126.00	118.20	110.40	102.70	94.90	87.10	79.30	71.60	63.80	56.00	48.20
\$920	\$960	131.60	123.80	116.00	108.30	100.60	92.70	84.00	77.20	69.40	61.60	53.80
\$960	\$1,000	137.20	129.40	121.60	113.90	106.10	98.30	90.60	82.80	75.00	67.20	59.40
		14 percent of the excess over \$1,000 plus—										
\$1,000 and over		140.00	132.20	124.40	116.70	108.90	101.10	93.30	85.60	77.80	70.00	62.20

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—												
		0	1	2	3	4	5	6	7	8	9	10 or more		
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—												
\$0-----	\$2.00-----	14% of wages	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
\$2.00-----	\$2.25-----	\$ .30	.05	0	0	0	0	0	0	0	0	0	0	0
\$2.25-----	\$2.50-----	.35	.10	0	0	0	0	0	0	0	0	0	0	0
\$2.50-----	\$2.75-----	.35	.10	0	0	0	0	0	0	0	0	0	0	0
\$2.75-----	\$3.00-----	.40	.15	0	0	0	0	0	0	0	0	0	0	0
\$3.00-----	\$3.25-----	.45	.20	0	0	0	0	0	0	0	0	0	0	0
\$3.25-----	\$3.50-----	.45	.20	0	0	0	0	0	0	0	0	0	0	0
\$3.50-----	\$3.75-----	.50	.25	0	0	0	0	0	0	0	0	0	0	0
\$3.75-----	\$4.00-----	.55	.30	.05	0	0	0	0	0	0	0	0	0	0
\$4.00-----	\$4.25-----	.60	.30	.05	0	0	0	0	0	0	0	0	0	0
\$4.25-----	\$4.50-----	.60	.35	.10	0	0	0	0	0	0	0	0	0	0
\$4.50-----	\$4.75-----	.65	.40	.15	0	0	0	0	0	0	0	0	0	0
\$4.75-----	\$5.00-----	.70	.45	.15	0	0	0	0	0	0	0	0	0	0
\$5.00-----	\$5.25-----	.70	.45	.20	0	0	0	0	0	0	0	0	0	0
\$5.25-----	\$5.50-----	.75	.50	.25	0	0	0	0	0	0	0	0	0	0
\$5.50-----	\$5.75-----	.80	.55	.30	0	0	0	0	0	0	0	0	0	0
\$5.75-----	\$6.00-----	.80	.55	.30	.05	0	0	0	0	0	0	0	0	0
\$6.00-----	\$6.25-----	.85	.60	.35	.10	0	0	0	0	0	0	0	0	0
\$6.25-----	\$6.50-----	.90	.65	.40	.15	0	0	0	0	0	0	0	0	0
\$6.50-----	\$6.75-----	.95	.65	.40	.15	0	0	0	0	0	0	0	0	0
\$6.75-----	\$7.00-----	.95	.70	.45	.20	0	0	0	0	0	0	0	0	0
\$7.00-----	\$7.25-----	1.00	.75	.50	.25	0	0	0	0	0	0	0	0	0
\$7.25-----	\$7.50-----	1.05	.80	.50	.25	0	0	0	0	0	0	0	0	0
\$7.50-----	\$7.75-----	1.05	.80	.55	.30	.05	0	0	0	0	0	0	0	0
\$7.75-----	\$8.00-----	1.10	.85	.60	.35	.10	0	0	0	0	0	0	0	0
\$8.00-----	\$8.25-----	1.15	.90	.65	.35	.10	0	0	0	0	0	0	0	0
\$8.25-----	\$8.50-----	1.15	.90	.65	.40	.15	0	0	0	0	0	0	0	0
\$8.50-----	\$8.75-----	1.20	.95	.70	.45	.20	0	0	0	0	0	0	0	0
\$8.75-----	\$9.00-----	1.25	1.00	.75	.50	.20	0	0	0	0	0	0	0	0
\$9.00-----	\$9.25-----	1.30	1.00	.75	.50	.25	0	0	0	0	0	0	0	0
\$9.25-----	\$9.50-----	1.30	1.05	.80	.55	.30	.05	0	0	0	0	0	0	0
\$9.50-----	\$9.75-----	1.35	1.10	.85	.60	.30	.05	0	0	0	0	0	0	0
\$9.75-----	\$10.00-----	1.40	1.15	.85	.60	.35	.10	0	0	0	0	0	0	0
\$10.00-----	\$10.50-----	1.45	1.20	.90	.65	.40	.15	0	0	0	0	0	0	0
\$10.50-----	\$11.00-----	1.50	1.25	1.00	.75	.50	.25	0	0	0	0	0	0	0
\$11.00-----	\$11.50-----	1.60	1.30	1.05	.80	.55	.30	.05	0	0	0	0	0	0
\$11.50-----	\$12.00-----	1.65	1.40	1.15	.90	.60	.35	.10	0	0	0	0	0	0
\$12.00-----	\$12.50-----	1.70	1.45	1.20	.95	.70	.45	.20	0	0	0	0	0	0
\$12.50-----	\$13.00-----	1.80	1.55	1.25	1.00	.75	.50	.25	0	0	0	0	0	0
\$13.00-----	\$13.50-----	1.85	1.60	1.35	1.10	.85	.60	.30	.05	0	0	0	0	0
\$13.50-----	\$14.00-----	1.95	1.65	1.40	1.15	.90	.65	.40	.15	0	0	0	0	0
\$14.00-----	\$14.50-----	2.00	1.75	1.50	1.25	.95	.70	.45	.20	0	0	0	0	0
\$14.50-----	\$15.00-----	2.05	1.80	1.55	1.30	1.05	.80	.55	.30	0	0	0	0	0
\$15.00-----	\$15.50-----	2.15	1.90	1.60	1.35	1.10	.85	.60	.35	.10	0	0	0	0
\$15.50-----	\$16.00-----	2.20	1.95	1.70	1.45	1.20	.95	.65	.40	.15	0	0	0	0
\$16.00-----	\$16.50-----	2.30	2.00	1.75	1.50	1.25	1.00	.75	.50	.25	0	0	0	0
\$16.50-----	\$17.00-----	2.35	2.10	1.85	1.60	1.30	1.05	.80	.55	.30	.05	0	0	0
\$17.00-----	\$17.50-----	2.40	2.15	1.90	1.65	1.40	1.15	.90	.65	.35	.10	0	0	0
\$17.50-----	\$18.00-----	2.50	2.25	1.95	1.70	1.45	1.20	.95	.70	.45	.20	0	0	0
\$18.00-----	\$18.50-----	2.65	2.30	2.05	1.80	1.55	1.30	1.00	.75	.50	.25	0	0	0
\$18.50-----	\$19.00-----	2.65	2.35	2.10	1.85	1.60	1.35	1.10	.85	.60	.30	.05	0	.15
\$19.00-----	\$19.50-----	2.70	2.45	2.20	1.95	1.65	1.40	1.15	.90	.65	.40	.15	0	.20
\$19.50-----	\$20.00-----	2.75	2.50	2.25	2.00	1.75	1.50	1.25	1.00	.70	.45	.20	0	.30
\$20.00-----	\$21.00-----	2.85	2.60	2.35	2.10	1.85	1.60	1.35	1.10	.80	.55	.30	.05	.45
\$21.00-----	\$22.00-----	3.00	2.75	2.50	2.25	2.00	1.75	1.50	1.20	.95	.70	.45	.20	.60
\$22.00-----	\$23.00-----	3.15	2.90	2.65	2.40	2.15	1.85	1.60	1.35	1.10	.85	.60	.35	.75
\$23.00-----	\$24.00-----	3.30	3.05	2.80	2.50	2.25	2.00	1.75	1.50	1.25	1.00	.75	.50	.85
\$24.00-----	\$25.00-----	3.45	3.15	2.90	2.65	2.40	2.15	1.90	1.65	1.40	1.15	.90	.65	1.00
\$25.00-----	\$26.00-----	3.65	3.30	3.05	2.80	2.55	2.30	2.05	1.80	1.50	1.25	1.00	.75	1.15
\$26.00-----	\$27.00-----	3.70	3.45	3.20	2.95	2.70	2.45	2.20	1.90	1.65	1.40	1.15	.90	1.30
\$27.00-----	\$28.00-----	3.85	3.60	3.35	3.10	2.85	2.55	2.30	2.05	1.80	1.55	1.30	1.05	1.45
\$28.00-----	\$29.00-----	4.00	3.75	3.50	3.20	2.95	2.70	2.45	2.20	1.95	1.70	1.45	1.20	1.60
\$29.00-----	\$30.00-----	4.15	3.85	3.60	3.35	3.10	2.85	2.60	2.35	2.10	1.85	1.60	1.35	1.75
14 percent of the excess over \$30 plus—														
\$30 and over-----		4.20	3.95	3.70	3.45	3.20	2.90	2.65	2.40	2.15	1.90	1.65	1.40	1.15

(c) WITHHOLDING OF TAX ON CERTAIN NONRESIDENT ALIENS.—

(1) Section 1441(a) (relating to general rule) is amended by striking out "the tax shall be equal to 18 percent of such item." and inserting in lieu thereof:

"the tax shall be equal to—

"(1) 15 percent in the case of payments made during the calendar year 1964, and

"(2) 14 percent in the case of payments made after December 31, 1964."

(2) Section 1441(b) (relating to income items) is amended by striking out "18 percent" and by inserting in lieu thereof "15 percent or 14 percent (as the case may be)".

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) of this section shall apply with respect to remuneration paid after December 31, 1963. The amendment made by subsection (c) of this section shall apply with respect to payments made after December 31, 1963.

Passed the House of Representatives September 25, 1963.

Attest:

RALPH R. ROBERTS,

*Clerk.*

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The CHAIRMAN. The first witness in open session will be the Honorable Douglas Dillon, Secretary of the Treasury, who is here to advocate passage of the bill, discuss its provisions, and perhaps to suggest certain changes he thinks should be made.

I know we all welcome Secretary Dillon.

Before the Secretary presents his statement, the Chair thinks it is appropriate briefly to review the rate of progress that has been made on this bill to date—both in the Finance Committee and elsewhere.

This seems to be necessary for the record in view of inferences contained in certain recent public statements—which have the characteristics of pressure propaganda—to the effect that there is undue delay in the procedure being followed by the committee.

The facts are:

The President, in a message to Congress on April 21, 1961—30 months ago—announced that he had directed the Treasury Department to prepare recommendations for comprehensive tax legislation.

It took the executive branch 21 months to prepare the recommendations. They were made to Congress in the President's tax message of January 24, 1963.

The House Committee on Ways and Means—which implements the constitutional responsibility of the House of Representatives for originating revenue legislation—started hearings and consideration of the President's recommendations on February 6, 1963. That was 8 months ago.

The Ways and Means Committee reported a bill—previously unavailable to either the Finance Committee, or the public—on September 13. That was a month ago.

A week later on September 19, 1963, the House Rules Committee reported the tax bill to the floor of the House of Representatives.

The House debated the bill, under a closed rule, for 2 days—September 24 and 25.

The pending bill (H.R. 8363) was referred to the Senate Finance Committee on September 30. That was 15 days ago, including Saturdays and Sundays. The committee cleared its calendar of other matters on October 1, preparatory to consideration of the tax bill.

On the same day the committee determined procedure for consideration of the bill; and the procedure being followed was adopted by a committee vote of 12 to 4.

The procedure adopted represents virtually no change from committee practice on major tax legislation for 30 years to my knowledge, and I have been a member for 30 years, under Chairman Pat Harrison, Walter George, and Eugene Millikin.

The only variation in the procedure has been to start a briefing of committee members on provisions in the House bill by the staff on the Joint Committee on Internal Revenue Taxation. The Secretary of the Treasury was advised of this change, and his reaction was favorable.

This is a major tax bill. It covers 304 pages. It contains 234 proposals to amend the complex Tax Code, and it would add 7 new provisions. It would involve every individual and corporate taxpayer in the country. It should not be considered lightly. It cannot be considered hurriedly.

The Finance Committee cannot overlook the fact that its members and the public—including the lawyers and accountants who represent taxpayers—have had relatively little opportunity to study the actual provisions in the bill as reported by the Ways and Means Committee; and there have been no public hearings on them.

This committee has always given the public a reasonable opportunity to be heard on major legislation before it.

This was done last year when the administration's 1962 tax bill was before the Finance Committee, and the committee's examination led to substantial changes, some at the request of the administration, itself. And the bill was passed as amended.

The same procedure was followed, also last year, with respect to the administration's reciprocal trade expansion bill.

On August 13, 1963, more than a year ago, when the President, in a nationwide broadcast, said tax bill recommendations would be submitted to Congress in January 1963, he took the position that there was no need for a "quickie" tax bill at that time.

In that same broadcast he said there was no indication of a recession, and that there was "every reason for confidence."

He repeated these views in a major tax program speech before the New York Economic Club on December 14, 1962.

In his tax message of January 24, this year, the President said the revisions he proposed were "not motivated by any threat of imminent recession," and his recommendations could be met under the January 1, 1964, effective date in the bill, if enacted.

The Ways and Means Committee considered the President's recommendations over a period of some 7 months. It took 4,000 pages of testimony in 7 volumes.

To date the bill, as reported by the Ways and Means Committee, and passed by the House, has been before the Finance Committee 2 weeks. And, to date, some 140 requests for time to be heard have been received. The testimony will be received in accordance with committee policy of long standing. The first of the witnesses in public hearing is Secretary Dillon.

The Chair recognizes the Secretary.

#### STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Mr. Chairman, since I submitted my statement to this committee about a week ago, I would like, with your permission, to have the privilege of reading parts of it and summarizing some of the rest of the data, particularly that part of the data that has been covered in the detailed briefings that the committee has received.

If that is all right, I would like to proceed that way.

The CHAIRMAN. Without objection.

Secretary DILLON. Mr. Chairman, members of the committee, last January, the President sent to the Congress a broad program of tax reduction and structural reform, designed to meet the Nation's most pressing economic problems: chronic employment, underutilization of industrial capacity, and continuing deficits, both in our international balance of payments and in our Federal budget.

The President recommended significant cuts in individual and corporate tax rates. He also recommended structural revisions that would broaden the tax base and remove certain inequities to permit larger reductions in tax rates than would otherwise have been possible.

The bill before you was drafted in the House after full consideration of the President's program. It is generally in accord with the President's program, although it differs in certain specific respects. It reduces tax revenues in scale, form, and with a timing pattern that meets the urgent needs of our economy—and the reduction is within the limits of fiscal prudence. With one important exception—in the treatment of capital gains—the bill fairly distributes the benefits of tax reduction among all income groups. It also contains important provisions that relieve hardship and lessen favoritism.

The need for a major program of tax reduction and revision is pressing. I firmly believe that to delay its passage would incur serious economic risks. Therefore, I appear before you today to urge your committee to give favorable consideration to H.R. 8363 as passed by the House with one principal exception. Because of the urgency of prompt action, I recommend that the committee eliminate the provisions in the bill dealing with capital gains, specifically those that relate to the new 40-percent inclusion factor and the new 21-percent ceiling rate for so-called class A capital gains.

The administration's position has always been that these controversial and complex features should only be dealt with in connection with the related and inseparable problem of the treatment of unrealized capital gains at death.

The tax reductions contained in this bill have been strongly endorsed by both business and labor, by financial leaders at home and abroad, and by a large cross section of the most distinguished economists in our universities.

After months of public debate in the press and other media, the bill was approved by a very substantial majority of the House of Representatives. In sum, there is a national consensus that the bill is a necessary and proper measure that is vital to our economic progress.

## I. THE IMPORTANCE OF TAX REDUCTION

### A. ECONOMIC EFFECTS

The President's tax program addresses the basic problem of chronic underemployment of manpower, plant, and equipment that has plagued us for more than 5 years. For the past 6 years unemployment has averaged 6 percent, and it has not fallen below 5 percent during that period. The rate of capacity utilization for plant and equipment has remained well below preferred operating rates.

Recessions have occurred all too frequently, and recoveries have fallen progressively shorter of full employment. Finally, corporate profits and the ratio of expenditures on plant and equipment to gross national product have been below previous postwar levels.

Despite the encouraging 1963 performance in certain sectors of the economy, I wish to emphasize that the underlying situation has not changed since the President presented his program last January. Although retail sales, personal income, civilian employment, and gross national product have all reached record levels during the present recovery, which has been underway since February 1961, our more pressing economic problems remain with us. Unemployment this year has averaged 5.7 percent and in September 5.6 percent of the labor force was still unemployed.

Capacity utilization remains well below preferred operating levels. A serious deficit in the balance of payments persists. Moreover, there is reason to believe that the expectation of major tax reduction has contributed to the 1963 advance.

Businessmen and individuals have based their spending plans, to some extent, upon their anticipation of significant across-the-board tax reductions. A substantial cutback of the proposed tax reduction, or a further delay in their implementation, might seriously affect the economy's vitality.

The present business cycle expansion is now in its 32d month. It is already 7 months longer than the expansion which ended in the recession of 1960 and now equals the average duration of our postwar peacetime recoveries. But in the 32d month of continual expansion, the unemployment rate is only slightly less than it was in the depths of the 1954 recession.

Although the economy is growing, it is doing so in a cyclical fashion in which the cycles mirror the economy's underlying inability to sustain, over any extended period, the rate of growth required to provide employment for our rapidly growing labor force.

When the President said in January that the—

largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative, and incentive—

he voiced a widely held view.

Without the basic reduction in tax burdens proposed in H.R. 8363, we increase the likelihood of repeating the disappointing record of recent business cycles. When recession occurs, the economy will fall from a plateau well below full employment and the subsequent recovery will again fall short of that goal. This is not to say that unless tax reduction is enacted—and enacted soon—recession will necessarily follow. It is only to suggest that without the thrust that significant tax reductions can provide, there is no basis in recent experience to predict or expect that the economy will break out of the disappointing pattern of recent years.

On the other hand, a substantial across-the-board reduction in taxes should give our economy the impetus it needs to put an end to this pattern of recession. While I recognize that a sustained period of rapid economic expansion such as we envisage with enactment of H.R. 8363 would be a new experience for the American economy, it would only parallel what is now being regularly achieved by the countries of Western Europe.

Our persisting problem has been insufficient demand. The Federal Government has the capacity to meet this problem and since the enactment of the Employment Act of 1946 it has had a clear responsibility to do so. Two entirely different courses are open.

Either additional Government expenditures, which mean bigger Central Government, or an increase in the growth of the private sector can stimulate our economy. The choice is whether the Government or private consumers and investors will control how our increased output is to be used. The administration, in support of H.R. 8363, has chosen the free enterprise, private economy course.

It prefers that course. This is the course that leaves to private individual and corporate spenders the decision as to which particular goods and services shall be purchased with the increase in demand that will flow from the substantial reductions we are recommending in our harsh tax rates. I feel certain that the great majority of Americans agree with the administration's preference for the tax reduction, private economy route to full production and full employment. The enactment of H.R. 8363 will carry out their desires.

H.R. 8363 is fully adequate to set us on a new path of growth. Tax reduction will augment both individual incomes and corporate earnings. Individual income tax liabilities will be lowered by \$9 billion. This will enhance consumer purchasing power, to be spent and respent, circulating through the economy, in a way that will increase overall consumer spending by several times the amount of the initial tax cut.

This sustained increase in the demand for consumer goods and services will in turn stimulate greater investment in plant and equipment. At the same time, tax reductions for corporations and businessmen will provide new investment incentive by raising the net return on capital.

Taken together with last year's depreciation reform and investment credit, the profitability of new investment will be increased by nearly 35 percent, and corporate tax liabilities will be reduced by more than \$4.5 billion. This increased profitability will bring enlarged investment spending, which in turn will generate still higher incomes and expanded consumption outlays.

Finally, the rise in our national output will expand the revenues of State and local governments and mitigate their mounting financial problems. State and local governments will be better able to support badly needed public facilities and services, and the pressure they are now under to raise tax rates or find new sources of tax revenue will be substantially reduced.

Thus the tax program envisaged in H.R. 8363 will have a balanced impact upon the economy, stimulating both consumption and investment. The forward thrust provided for the economy will be greater than if the tax reduction were concentrated on either sector alone.

The higher level of business investment under a more favorable tax environment will greatly increase the productivity of our economy. This improved productivity will facilitate the development of new and better products, thus enabling us to compete more effectively in international trade.

A higher rate of return on investment will make investment at home more attractive relative to investment abroad, and will also attract more foreign capital to our shores.

Substantial improvement of the investment environment in the United States is essential if we are to achieve a stable balance in our international payments. This is why the President, in his recent statement on the balance of payments, urged the tax reduction program as the single most important step that could be taken to achieve balance abroad as well as growth at home.

#### B. BUDGETARY IMPACT

While we strongly advocate tax reduction as the best means of achieving a desirable, full employment growth rate, we also believe that it must be accompanied by a most prudent management of the Government's fiscal affairs. Our repressive tax structure prevents our economy from operating at reasonably full capacity. This failure to reach capacity operations in turn reduces profits and incomes and so reduces our revenues. Therefore, paradoxical though it may seem, tax reduction today provides the best and quickest route to a balanced budget.

This comes about simply from the fact that the tax base rises and falls with economic activity. The economic expansion we can expect from passage of H.R. 8363 will thus "feed back" increased tax revenues sufficient to achieve a balanced budget at substantially reduced tax rates, provided expenditures are restrained.

With prompt enactment of this bill, we now expect the deficit for fiscal year 1964 to be less than \$9.2 billion, which was the deficit originally forecast by the President last January before any allowance for the effects of tax reduction. This improved budgetary outlook reflects the economy's expansion and resulting higher tax revenues, the delay in the effective date of the tax cuts, and also a reduction in prospective expenditure levels.



As for fiscal year 1965 and following years, the President has assured the Congress that he intends to maintain a tight rein on expenditures and that a substantial part of the tax revenues from economic expansion will be used to reduce the budgetary deficit until balance is reached.

On this basis—and barring an unforeseen slowdown of the economy or international contingency—the President expects to submit a budget for fiscal 1965 with a deficit less than presently forecast for fiscal 1964, despite the fact that the second stage of the tax reduction will have gone into effect and that the revenue loss from tax reduction in 1965—before feedback—will be \$5 billion greater than in 1964.

The House in turn has emphasized these factors by specifically referring to them in section 1 of the bill. The bill states:

It is the sense of Congress that the tax reduction provided by this Act through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt.

Thus, our real choice regarding budget deficits is whether we shall have a small and temporary increase in our deficit as a byproduct of much-needed tax revision designed to stimulate the economy and lead to budgetary balance, or whether we shall continue to live with the deficits that have characterized recent years and which, in the absence of tax reduction, will stay with us no matter how much we attempt to limit expenditures. This is so because our present repressive tax structure guarantees recurring recessions and underemployment of our human and material resources, which inevitably bring deficits in their wake.

During the recent debate on H.R. 8363 in the House of Representatives, virtually the only element of controversy was over the way in which to insure the expenditure control needed to reach balance in the next few years. There was little disagreement on the necessity for prompt and broad-scale tax reduction. There was no disagreement at all over the fact that such tax reduction should be accompanied by firm expenditure control.

It was the view of a substantial minority that the necessary expenditure control could best be achieved by setting limits on the estimates of expenditures for the fiscal year 1964 and 1965 which are to be submitted by the President next January.

A fundamental weakness in this particular approach is the fact that actual expenditures for these 2 years could vary significantly from January estimates for many reasons, a good number of which are not subject to Presidential control.

Past experience has shown this to be the case. On the other hand, expenditures can never exceed the amounts actually appropriated by the Congress. Effective expenditure control thus requires a joint effort by the President and the Congress. Recognizing this fact, the majority of the House felt that the generally desired expenditure control would be more likely of achievement during the years ahead by the acceptance of joint Presidential and congressional responsibility as outlined in section 1 of the bill. The President on numerous occasions has clearly indicated his sympathy for this approach and his recognition of the need for expenditure control. With the cooperation

of the Congress, I am certain that it can be achieved. There is thus no reason to delay the long-needed reduction in our repressive tax rates.

Some people have criticized tax reduction on the ground that the temporary increase in the budgetary deficit that would flow from enactment of H.R. 8363 would pose an unacceptable danger of inflation. This criticism is based upon an erroneous view of the cause of inflation. Whether inflation occurs depends on the state of the whole economy, not just on the Federal budget. It can be due either to an excess of demand over supply to a situation where costs of production rise more rapidly than productivity. For the past 5 years neither type of inflation has been present in our economy. Wholesale prices have stayed level since 1958 and wage increases remain within the bounds of the improvement in productivity.

At present our economy is marked, not by inflationary pressures, but by unused plant capacity and unemployed workers. Our idle resources are fully capable of producing an additional \$30 to \$40 billion of goods and services which would match the increased private spending that we can expect from this bill. Under such conditions additional private spending, stimulated by a tax cut, will increase output and employment rather than prices.

The general outline, of the bill, is indicated by the table in my statement. This table shows that there is a reduction scheduled under this bill of \$7.075 billion of calendar year liabilities in 1964 and \$11.075 billion in 1965.

It shows that rate reductions amount to \$7,630 million in 1964 and \$11,660 billion in 1965, that revenue raising changes in the bill amount to \$1,240 billion in 1964 and \$1,319 billion in 1965.

These are offset by certain revenue reducing specific proposals which will reduce revenue by \$685 million in 1964 and \$725 million in 1965.

The net change or the structural changes are \$555 million in 1964 and \$585 million in 1965, a plus.

The end result is in 1965, a reduction for individuals of \$8.750 billion and a reduction for corporations of \$2.325 billion.

In my statement, I cover the effect of the bill on budget receipts which, on a fiscal year basis, naturally differs from the calendar year calculation just discussed.

Based on calendar 1963 estimated income levels and without taking into account the stimulating effect on the economy, over and above current rates of economic growth, of the tax reductions, fiscal year 1964, which ends next June, would, under the bill, show a decrease in revenues of \$2.190 billion, and fiscal 1965 would show a decrease of \$7.395 billion. However, we estimate that the net revenue cost after taking account of the economic stimulus will be \$1.8 billion in fiscal 1964 and \$3.5 billion in the fiscal year 1965.

As to the reductions as a whole, the bill when fully effective would reduce individual liabilities by \$8¾ billion, which nearly equals 80 percent of the total tax reduction in the bill. Such emphasis on the individual income tax is entirely appropriate, however, in the light of the significant reductions in corporate taxes effected last year through revision of depreciation guidelines and enactment of the investment tax credit.

These two provisions reduced corporate tax liabilities by about \$2.25 billion in 1962. They also reduced individual taxes payable on the profits of unincorporated business by about another \$250 million. When these tax actions are included, the reductions made in 1962 and proposed for 1965 total \$13.6 billion for both individuals and corporations. Of this total just over \$4.5 billion, or one-third, will go to corporations and the remaining two-thirds will go to individuals, and allocation which is roughly in proportion to the current division of income tax revenues between corporations and individuals. Hence, the bill, we feel, distributes the tax reduction equitably.

Taxpayers at all income levels will receive significant tax reductions, averaging 18.8 percent after the structural changes are taken into account and averaging 20 percent before calculating any such changes. Those at the lowest income levels will receive a larger percentage tax reduction than individuals at higher income levels. Persons with incomes of less than \$3,000 will be given tax reductions averaging about 38 percent. On the other hand, persons with incomes of \$50,000 or more will receive reductions averaging approximately 13 percent.

The equitable distribution of tax reduction proposed in this bill would be seriously distorted if the structural revisions accompanying the rate reductions were significantly altered. The structural revisions further reduce liabilities for those with incomes of less than \$5,000 and partially offset the rate reduction impact among those with higher incomes. Without the structural revisions, tax reduction would be much less favorable to the needy persons at low income levels and much more favorable to persons with higher incomes.

My written statement contains a description of rate revision with which the committee is fully familiar. I would merely like to emphasize that the corporate rate change was designed to give important tax benefits to small businesses. The House bill reduces the normal rate from 30 to 22 percent on the first \$25,000 of taxable income. In effect, the taxes of the business with income under \$25,000, a group that includes 467,500 out of 576,000 taxpaying corporations will be reduced by 26.7 percent against a reduction of 7.7 percent for very large companies. The revised tax structure would thereby strengthen the internal financing of small businesses that have less ready access to the capital markets and are more dependent on internal funds for new investment. The vitality of small business, so essential to our competitive economy, will thus be better assured. The over 9 million small individual proprietorships will of course benefit from comparable reductions in individual income tax rates.

In my written statement, I also refer to the fact that the House bill would, over a period of 7 years place large corporations on a current payment basis, as is presently the case for individuals.

The current payment provision applies only to corporate tax liabilities in excess of \$100,000.

This shift would take place gradually so that in no year will any corporation with constant income have to pay more tax than it would have been paying this year. In other words, the amount of the shift will be offset by the reduction in the corporate rates that are proposed. By 1970, taxpayments of all large corporations would be fully current, with 25 percent of their year's tax liabilities in excess of \$100,000 paid in each quarter. Payment requirements would be subject

to the relief provisions of present law. The corporations involved should experience no difficulty in adjusting to the current payments schedule. Because current payments would not be required on the first \$100,000 of tax liabilities, the effect of the provision would be limited to 15,000 or so large corporations and only a small proportion of those companies would have a substantial accelerated payment to make. The 15,000 large corporations account for about 2½ percent of the total number of corporations with taxable income.

Many of the larger companies that will be subject to the full effect of accelerated payments conventionally fund their tax liabilities by investment in Treasury tax notes and other short-term securities. In general, then, the accelerated payments would not disturb their net working capital. Current payments would liquidate accrued income taxes payable and, therefore, reduce short-term liabilities by an equivalent amount.

My written statement contains a description of various structural provisions on which the committee has been previously briefed. I would like to turn now to the capital gains area, where we do recommend a change.

It is the only basic change we recommend.

Under present law 50 percent of the net capital gains of individuals on assets held more than 6 months are includable in income subject to tax at the regular rates, except that the tax may not exceed 25 percent on net capital gains in any event.

Thus the general-rate reduction of the House bill automatically reduces the tax on long-term capital gains for all those below a 50-percent marginal tax rate, at which point the 25-percent ceiling takes hold.

Under the House bill this marginal rate would start at \$44,000 of taxable income for a married taxpayer instead of \$32,000 as under present law.

The House bill provides a reduction in the effective tax rate for assets sold after a 2-year holding period. Only 40 percent of the gain on such assets would be included in income instead of 50 percent and the maximum tax would be 21 percent instead of 25 percent.

Capital gains on assets held more than 6 months but not more than 2 years would continue to be includable at 50 percent with a maximum tax of 25 percent. The so-called statutory capital gains—income not truly derived from the sale of capital assets, such as lump-sum distributions from pension plans, gain on cutting of timber inventories, and the like—would remain in the 50-percent inclusion—25-percent maximum rate category.

For those taxpayers not using the alternate rate—97 percent of all tax returns with capital gains—the combination of the reduction in the inclusion factor and the lower ordinary income rates affords a 35-percent reduction in tax on capital gains as opposed to a 19-percent reduction on ordinary income.

This reduction in the House bill to a 40-percent inclusion factor and the 21-percent limitation is unacceptable to the administration.

It provides a rate reduction which will largely benefit our wealthier citizens without treating a concomitant problem of equity in capital gains taxation, namely, that gains which are unrealized at the time of death are never subject to income taxes. A man who accumulates an

estate from salary or dividends, or business profit, pays income tax on the accumulation during his lifetime and then if the estate is large enough, his estate may be liable for estate tax when he dies. The same is true of a man who builds up a valuable business and sells it before he dies.

However, the individual who holds appreciated assets until death, as well as his heirs, escape all income and capital gains tax applicable to their gains, since the tax cost or basis to the heir is stepped up to the value of the property in the gross estate of the decedent.

This situation is not only a special benefit to owners of capital assets, but it seriously "locks in" capital holdings.

Indeed, it may be a principal cause of the lock-in problem for which other remedies are suggested. Older taxpayers frequently feel they can't afford to sell appreciated capital assets when they know that the capital gains tax can be completely avoided by passing the assets to their heirs.

The President specifically stated in his tax message last January that no reduction in the capital gains rate of taxation is justified unless a tax is imposed—

at capital gains rates on all net gains accrued on capital assets at the time of transfer at death or by gift.

The Ways and Means Committee tentatively approved an alternative provision for carryover of a decedent's basis at death which was reasonably satisfactory, since it meant that the capital gains tax on the before-death appreciation would be paid when the property was sold by the heir. At the last moment, however, the Ways and Means Committee decided to delete the provision because it was dissatisfied with the language presented to it and wanted more time to work out technical details.

Without a provision either for carryover of basis or for taxation at the time of transfer at death, the capital gains rate changes should be deleted from the House bill and the entire matter put over until the problem can be solved as a whole.

Without closing the escape hatch by which our wealthier taxpayers can avoid all taxation on substantial amounts of capital gains, there is no justification for a reduction in rates of primary benefit to such taxpayers.

The present 50-percent inclusion factor and 25-percent ceiling provide enough of an advantage for those whose income is derived from profits on the sale of capital assets. Moreover, since the House provisions involve a three-step arrangement of capital gain inclusions and two maximum rates, they seriously complicate the capital gain portion of the tax return and of the code.

The deletion of this feature would lower the longrun annual revenue loss in the bill by about \$140 million a year. We would, however, have to forgo a temporary 2-year increase in revenues during fiscal 1965 and 1966, which had been foreseen because of the initial one-time "unlocking effects" of the reductions in capital gain tax rates, amounting to \$210 million in fiscal 1965 and \$80 million in fiscal 1966. These calculations are shown in more detail in the table 6, attached to my written statement.

Finally, I would just like to say a word about the amendment to the Revenue Act of 1962 dealing with the investment tax credit.

This amendment was not suggested by the administration, but was put into the bill by the Ways and Means Committee. We strongly concurred in the Ways and Means Committee action, however, and we now support the amendment. By way of background, last year the Congress, in approving the investment credit, decided that the depreciation basis of the assets should be reduced by the amount of the credit. This naturally reduced the effectiveness of the credit and we were disappointed about that last year. The reduction in basis cut the inducement to new investment provided by the credit almost in half. During the course of the year, other unforeseen problems have also arisen, largely in the accounting and the administrative field. This led, however, to strong feelings by many businesses, and considerable testimony asking that the basis reduction provision be removed.

Briefly, in most States, taxpayers are not required to reduce their depreciation basis to reflect the investment tax credit when computing income for State tax purposes. Consequently, taxpayers in these States now must keep two different sets of accounts in which their various assets have different bases. In addition, the basis reduction complicates the computation of earnings and profits, produces difficulties in the pricing of defense contracts, and also complicates the bookkeeping requirements of regulated companies. None of these things were fully foreseen by the Treasury last year at the time of the enactment of the law and I assume they were not foreseen by the Congress either. It is in view of this that we feel that it is important to have this provision—which would delete the the basis reduction rule—approved.

In addition, approval of the investment credit provision is of particular importance to our current international balance-of-payments difficulties. Adoption of this investment credit provision will bring our treatment of new investment close to or practically equivalent to that abroad. We made great steps in this direction with last year's investment credit, and also with depreciation reform, but our new investment is behind that of most European countries. With the adoption of this amendment, we should achieve a parity with new investment abroad. This stimulus to investment in the United States is vitally important to our program of reaching equilibrium in our international balance-of-payments position.

In conclusion, Mr. Chairman, I wish to emphasize the urgent need for prompt action along the lines suggested by this bill to reduce taxes and strengthen the economy. We can no longer delay decisive action to restore the full measure of economic vigor. The unemployment problem at home is serious. Equally serious is our balance-of-payments problem. Reduced tax rates and the structural revisions adopted for equity purposes will increase the reward for effort, enterprise, and risk taking, and will thus enhance individual initiative and stimulate investment. These factors will provide the needed spur to full employment and a faster rate of economic growth.

The revenue loss incurred in the first few years because of this bill will be temporary. In combination with the program of strict expenditure control announced by the President, the stimulating effects of tax reduction on the economy should produce sufficient revenue gains in the future to enable us to balance the budget.

It is essential to the well-being of the Nation that every effort be made to complete action on this bill before the end of the current year. The encouraging expansion of economic activity which has occurred thus far during the year is no doubt in part the result of favorable speculation regarding tax reduction. Failure to act on this bill might produce adverse psychological reactions throughout the country which would check the growth of our economy. The Nation has waited too long for relief from the stifling burden of excess taxes. Although the problems placed upon Congress and this committee are many and pressing, nothing is more important to the health of the Nation than decisive and prompt action along the lines provided by this bill.

I have attached to my written statement, Mr. Chairman, a number of tables, 7 in number, and also 13 exhibits which deal in detail with a number of the structural changes.

Thank you, Mr. Chairman.

(The complete prepared statement of Hon. Douglas Dillon, Secretary of the Treasury, with attachments, follows:)

STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE  
TREASURY, BEFORE THE SENATE FINANCE COMMITTEE

Last January, the President sent to the Congress a broad program of tax reduction and structural reform designed to meet the Nation's most pressing economic problems: chronic unemployment, underutilization of industrial capacity, and continuing deficits, both in our international balance of payments and in our Federal budget.

The President recommended significant cuts in individual and corporate tax rates. He also recommended structural revisions that would broaden the tax base and remove certain inequities to permit larger reductions in tax rates than would otherwise have been possible.

The bill before you was drafted in the House after full consideration of the President's program. It is generally in accord with the President's program, although it differs in certain specific respects. It reduces tax revenues in scale, form, and with a timing pattern that meets the urgent needs of our economy—and the reduction is within the limits of fiscal prudence. With one important exception—in the treatment of capital gains—the bill fairly distributes the benefits of tax reduction among all income groups. It also contains important provisions that relieve hardship and lessen favoritism.

The need for a major program of tax reduction and revision is pressing. I firmly believe that to delay its passage would incur serious economic risks. Therefore, I appear before you today to urge your committee to give favorable consideration to H.R. 8363 as passed by the House with one principal exception. Because of the urgency of prompt action, I recommend that the committee eliminate the provisions in the bill dealing with capital gains, specifically those that relate to the new 40-percent inclusion factor and the new 21-percent ceiling rate for so-called class A capital gains. The administration's position has always been that these controversial and complex features should only be dealt with in connection with the related and inseparable problem of the treatment of unrealized capital gains at death.

The tax reductions contained in this bill have been strongly endorsed by both business and labor, by financial leaders at home and abroad, and by a large cross section of the most distinguished economists in our universities. After months of public debate in the press and other media, the bill was approved by a very substantial majority of the House of Representatives. In sum, there is a national consensus that the bill is a necessary and proper measure that is vital to our economic progress.

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Despite the encouraging 1963 performance in certain sectors of the economy, I wish to emphasize that the underlying situation has not changed since the President presented his program last January. Although retail sales, personal income, civilian employment, and gross national product have all reached record levels during the present recovery, which has been underway since February 1961, our more pressing economic problems remain with us. Unemployment this year has averaged 5.7 percent and in September 5.6 percent of the labor force was still unemployed. Capacity utilization remains well below preferred operating levels. A serious deficit in the balance-of-payments persists. Moreover there is reason to believe that the expectation of major tax reduction has contributed to the 1963 advance. Businessmen and individuals have based their spending plans, to some extent, upon their anticipation of significant across-the-board tax reductions. A substantial cutback of the proposed tax reductions, or a further delay in their implementation, might seriously affect the economy's vitality.

The present business cycle expansion is now in its 32d month. It is already 7 months longer than the expansion which ended in the recession of 1960 and now equals the average duration of our postwar peacetime recoveries. But in the 32d month of continued expansion, the unemployment rate is only slightly less than it was in the depths of the 1954 recession. Although the economy is growing, it is doing so in a cyclical fashion in which the cycles mirror the economy's underlying inability to sustain, over any extended period, the rate of growth required to provide employment for our rapidly growing labor force.

When the President said in January that the "largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative, and incentive," he voiced a widely held view. Without the basic reduction in tax burdens proposed in H.R. 8363, we increase the likelihood of repeating the disappointing record of recent business cycles. When recession occurs, the economy will fall from a plateau well below full employment and the subsequent recovery will again fall short of that goal. This is not to say that unless tax reduction is enacted—and enacted soon—recession will necessarily follow. It is only to suggest that without the thrust that significant tax reductions can provide, there is no basis in recent experience to predict or expect that the economy will break out of the disappointing pattern of recent years. On the other hand, a substantial across-the-board reduction in taxes should give our economy the impetus it needs to put an end to this pattern of recession. While I recognize that a sustained period of rapid economic expansion such as we envisage with enactment of H.R. 8363 would be a new experience for the American economy, it would only parallel what is now being regularly achieved by the countries of Western Europe.

Our persisting problem has been insufficient demand. The Federal Government has the capacity to meet this problem and since the enactment of the Employment Act of 1946 it has had a clear responsibility to do so. Two entirely different courses are open. Either additional Government expenditures, which mean bigger Central Government, or an increase in the growth of the private sector can stimulate our economy. The choice is whether the Government or private consumers and investors will control how our increased output is to be used. The administration, in supporting H.R. 8363, has chosen the free enterprise, private economy course. It prefers that course. This is the course that leaves to private individual and corporate spenders the decision as to which particular goods and services shall be purchased with the increase in demand that will flow from the substantial reductions we are recommending in our harsh tax rates. I feel certain that the great majority of Americans agree with the administration's preference for the tax reduction, private economy



route to full production and full employment. The enactment of H.R. 8363 will carry out their desires.

H.R. 8363 is fully adequate to set us on a new path of growth. Tax reduction will augment both individual incomes and corporate earnings. Individual income tax liabilities will be lowered by \$9 billion. This will enhance consumer purchasing power, to be spent and respent, circulating through the economy, in a way that will increase overall consumer spending by several times the amount of the initial tax cut.

This sustained increase in the demand for consumer goods and services will in turn stimulate greater investment in plant and equipment. At the same time, tax reductions for corporations and businessmen will provide new investment incentives by raising the net return on capital. Taken together with last year's depreciation reform and investment credit, the profitability of new investment will be increased by nearly 35 percent, and corporate tax liabilities will be reduced by more than \$4.5 billion. This increased profitability will bring enlarged investment spending, which in turn will generate still higher incomes and expanded consumption outlays.

Finally, the rise in our national output will expand the revenues of State and local governments and mitigate their mounting financial problems. State and local governments will be better able to support badly needed public facilities and services, and the pressure they are now under to raise tax rates or find new sources of tax revenue will be substantially reduced.

Thus the tax program envisaged in H.R. 8363 will have a balanced impact upon the economy, stimulating both consumption and investment. The forward thrust provided for the economy will be greater than if the tax reduction were concentrated on either sector alone.

The higher level of business investment under a more favorable tax environment will greatly increase the productivity of our economy. This improved productivity will facilitate the development of new and better products, thus enabling us to compete more effectively in international trade. A higher rate of return on investment will make investment at home more attractive relative to investment abroad, and will also attract more foreign capital to our shores. Substantial improvement of the investment environment in the United States is essential if we are to achieve a stable balance in our international payments. This is why the President, in his recent statement on the balance of payments, urged the tax-reduction program as the single most important step that could be taken to achieve balance abroad as well as growth at home.

#### B. BUDGETARY IMPACT

While we strongly advocate tax reduction as the best means of achieving a desirable, full employment growth rate, we also believe that it must be accompanied by a most prudent management of the Government's fiscal affairs. Our repressive tax structure prevents our economy from operating at reasonably full capacity. This failure to reach capacity operations in turn reduces profits and incomes and so reduces our revenues. Therefore, paradoxical though it may seem, tax reduction today provides the best and quickest route to a balanced budget. This comes about simply from the fact that the tax base rises and falls with economic activity. The economic expansion we can expect from passage of H.R. 8363 will thus "feed back" increased tax revenues sufficient to achieve a balanced budget at substantially reduced tax rates, provided expenditures are restrained.

With prompt enactment of this bill, we now expect the deficit for fiscal year 1964 to be less than \$9.2 billion, which was the deficit originally forecast by the President last January before any allowance for the effects of tax reduction. This improved budgetary outlook reflects the economy's expansion and resulting higher tax revenues, the delay in the effective date of the tax cuts, and also a reduction in prospective expenditure levels.

As for fiscal year 1965 and following years, the President has assured the Congress that he intends to maintain a tight rein on expenditures and that a substantial part of the tax revenues from economic expansion will be used to reduce the budgetary deficit until balance is reached. On this basis—and barring an unforeseen slowdown of the economy or international contingency—the President expects to submit a budget for fiscal 1965 with a deficit less than presently forecast for fiscal 1964, despite the fact that the second stage of the tax reduction will have gone into effect and that the revenue loss from tax reduction in 1965 (before feedback) will be \$5 billion greater than in 1964.

The House in turn has emphasized these factors by specifically referring to them in section 1 of the bill. The bill states:

"It is the sense of Congress that the tax reduction provided by this Act through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt."

Thus, our real choice regarding budget deficits is whether we shall have a small and temporary increase in our deficit as a byproduct of much needed tax revision designed to stimulate the economy and lead to budgetary balance, or whether we shall continue to live with the deficits that have characterized recent years and temporary increase in our deficit as a byproduct of much-needed tax revision we attempt to limit expenditures. This is so because our present repressive tax structure guarantees recurring recessions and underemployment of our human and material resources, which inevitably bring deficits in their wake.

During the recent debate on H.R. 8363 in the House of Representatives, virtually the only element of controversy was over the way in which to insure the expenditure control needed to reach balance in the next few years. There was little disagreement on the necessity for prompt and broad-scale tax reduction. There was no disagreement at all over the fact that such tax reduction should be accompanied by firm expenditure control.

It was the view of a substantial minority that the necessary expenditure control could best be achieved by setting limits on the estimates of expenditures for the fiscal years 1965 and 1966 which are to be submitted by the President next January. A fundamental weakness in this particular approach is the fact that actual expenditures for these 2 years could vary significantly from the January estimates for many reasons, a good number of which are not subject to Presidential control. Past experience has shown this to be the case. On the other hand, expenditures can never exceed the amounts actually appropriated by the Congress. Effective expenditure control thus requires a joint effort by the President and the Congress. Recognizing this fact the majority of the House felt that the generally desired expenditure control would be more likely of achievement during the years ahead by the acceptance of joint Presidential and congressional responsibility as outlined in section 1 of the bill. The President on numerous occasions has clearly indicated his sympathy for this approach and his recognition of the need for expenditure control. With the cooperation of the Congress, I am certain that it can be achieved. There is thus no reason to delay the long needed reduction in our repressive tax rates.

Some people have criticized tax reduction on the ground that the temporary increase in the budgetary deficit that would flow from enactment of H.R. 8363 would pose an unacceptable danger of inflation. This criticism is based upon an erroneous view of the cause of inflation. Whether inflation occurs depends on the state of the whole economy, not just on the Federal budget. It can be due either to an excess of demand over supply or to a situation where costs of production rise more rapidly than productivity. For the past 5 years neither type of inflation has been present in our economy. Wholesale prices have stayed level since 1958 and wage increases remain within the bounds of the improvement in productivity.

At present our economy is marked, not by inflationary pressures, but by unused plant capacity and unemployed workers. Our idle resources are fully capable of producing an additional \$30 to \$40 billion of goods and services which would match the increased private spending that we can expect from this bill. Under such conditions additional private spending, stimulated by a tax cut, will increase output and employment rather than prices.

## II. SIZE, TIMING, AND DISTRIBUTIONAL EFFECTS

Let me now discuss this bill in greater detail.

### A. GENERAL OUTLINE

The bill provides across-the-board individual and corporate rate reductions, which, when combined with the various structural changes, will reduce revenues by \$7.08 billion in the calendar year 1964, and by \$11.08 billion in calendar year 1965.

On January 1, 1964 individual income tax rates are to be reduced by two-thirds of the full reduction planned for 1965. The calendar year 1964 rates will range from 16 percent to 77 percent, instead of the present range of 20 percent to

91 percent. The withholding rate will drop on January 1, 1964, from 18 percent to 15 percent. On January 1, 1965, tax rates ranging from 14 percent to 70 percent will become effective and the withholding rate will drop to 14 percent. (See attached table 1 for greater detail.)

On January 1, 1964, the corporate normal tax rate, which is applicable to all taxable corporate income, will be reduced from 30 percent to 22 percent, a reduction of 26.7 percent. Simultaneously the surtax rate, which applies to corporate taxable income in excess of \$25,000, will be raised from 22 percent to 28 percent. These changes will reduce the combined normal and surtax rate from its present 52 percent to 50 percent. On January 1, 1965, the surtax rate will be reduced by 2 percentage points to 26 percent. For 1965 and subsequent years, the combined normal and surtax rate will thus be 48 percent.

The principal revenue effects, based on 1963 levels of income, before any "feedback" in revenue from economic stimulation may be summarized as follows:

[In millions of dollars]

	Calendar year liabilities	
	1964	1965
<b>Rate changes:</b>		
Individuals.....	-6,310	-9,470
Corporations.....	-1,320	-2,190
Total.....	-7,630	-11,660
<b>Structural changes, capital gains revision, and revision of 1962 legislation:</b>		
<b>Revenue raising:</b>		
Individuals.....	+1,165	+1,220
Corporations.....	+75	+90
Total.....	+1,240	+1,310
<b>Revenue reducing:</b>		
Individuals.....	-495	-500
Corporations.....	-190	-225
Total.....	-685	-725
<b>Total, structural:</b>		
Individuals.....	+670	+720
Corporations.....	-115	-135
Total.....	+555	+585
<b>Total:</b>		
Individuals.....	-5,640	-8,750
Corporations.....	-1,435	-2,825
Total.....	-7,075	-11,075

See attached table 2 for greater detail. The capital gain revisions will create revenue gains during the first 2 years they are in effect due to their "unlocking" effect; but a revenue reduction will occur after 1965. (See table 6 for detail.) The effect on budget receipts is estimated to be:

[In millions of dollars]

	Fiscal year receipts	
	1964	1965
<b>Rate changes:</b>		
Individuals.....	-2,430	-7,530
<b>Corporations:</b>		
Before acceleration of payments.....		-1,320
Acceleration of payments.....	+260	+900
Total, corporations.....	+260	-420
Total, rate changes.....	-2,170	-7,950
<b>Structural changes and capital gains revision.....</b>	-20	+555
<b>Total.....</b>	-2,190	-7,395

Structural changes and capital gains revision affect corporation income tax payments only in the fiscal year 1964; the effect of such changes in the fiscal year 1965 is the same as on calendar year 1964 liabilities.

These estimated reductions in budget receipts are based on calendar year 1963 estimated income levels and are computed before any account in taken of the stimulating effect on the economy, over and above current rates of economic growth, of the tax reductions. The net revenue cost after taking account of economic stimulus, is estimated to be \$1.8 billion in the fiscal year 1964 and \$3.5 billion in the fiscal year 1965.

#### B. INDIVIDUALS AND CORPORATIONS

H.R. 8363, when taken in conjunction with the 1962 tax action, distributes the benefits of tax reduction between individuals and corporations in proportion to their relative contributions to Federal revenues from the income tax.

The bill, when fully effective, would reduce individual liability by \$8.7 billion, which nearly equals 80 percent of the total tax reduction. Such emphasis on the individual income tax is entirely appropriate, however, in the light of the significant reductions in corporate taxes effected last year through revision of depreciation guidelines and enactment of the investment tax credit. These two provisions reduced corporate tax liabilities by about \$2.25 billion in 1962. They also reduced individual taxes payable on the profits of unincorporated business by about another \$250 million. When these tax actions are included, the reductions made in 1962 and proposed for 1965 total \$13.6 billion for both individuals and corporations. Of this total just over \$4.5 billion, or one-third, will go to corporations and the remaining two-thirds will go to individuals, an allocation which is roughly in proportion to the current division of income tax revenues between corporations and individuals.

Viewed from another standpoint, the net individual tax reduction, excluding capital gains provisions, will reduce present tax liabilities for individuals by just under 19 percent. The combined effects of this bill, depreciation reform, and last year's investment tax credit, will reduce corporate tax liabilities by something more than 17 percent.

#### C. EQUITABLE DISTRIBUTION AMONG INDIVIDUALS

The bill distributes the tax reduction equitably. Taxpayers at all income levels will receive significant tax reductions, averaging 18.8 percent even after taking account of structural changes. Those at the lowest income levels, however, will receive the largest percentage tax reductions while those at higher income levels will receive smaller percentage reductions. Those persons with incomes of less than \$3,000 will be given tax reductions averaging about 38 percent. On the other hand, persons with incomes of \$50,000 or more will receive reductions averaging approximately 13 percent. These differentials (presented in more detail in the attached tables 3 and 4) are equitable since even minimal tax burdens impose hardship on those at very low income levels and since even small percentage reductions applied to higher brackets represent large amounts of after-tax incomes.

The equitable distribution of tax reductions this bill contains would be seriously distorted if the structural revisions accompanying the rate reductions were significantly altered. These revisions reduce liabilities for those with incomes of less than \$5,000 and partially offset the rate reduction impact among those with higher incomes. Without the structural revisions, tax reduction would be much less favorable to the needy persons at low income levels and much more favorable to persons with higher incomes.

### III. TAX RATES

#### A. INDIVIDUAL TAX RATES

The most important part of H.R. 8363 is a top-to-bottom reduction in individual income tax rates. These rates, which now range from 20 percent to 91 percent, are reduced in two steps to a new level of 14 to 70 percent. The 14- to 70-percent rates would take effect in 1965. For the 1964 interim year, the rates would be two-thirds of the full reduction, to range from 16 to 77 percent.

With the exception of adjustments at the bottom end of the tax scale favoring single taxpayers with \$1,500 or less of taxable income and married persons with less than \$3,000 of taxable income, and adjustments in the upper levels where the rate scale has long been recognized as unrealistically high, the rate reductions are geared to the present tax scale with reductions varying from

14 to 17 percent in various brackets. These variations are necessary because of the desirability of rounding in the interest of avoiding fractional rates.

A distinctive feature of this rate scale is the manner in which it would treat the present first taxable income bracket. This bracket, which includes the first \$2,000 of a single person's taxable income—income after deductions and exemptions—and the first \$4,000 of a married couple's taxable income, is currently taxed at the rate of 20 percent. Over 50 percent of all taxpayers have taxable incomes that fall wholly within this bracket and pay tax only at the 20-percent rate. H.R. 8363 would split the bracket into four equal segments, \$500 segments for single persons and \$1,000 segments for married couples. Tax rates of 14, 15, 16, and 17 percent would apply to these four brackets. These rates average 22.5 percent less than the existing rate. This average does not, however, fully describe the effect of this provision. About 10 percent of all taxpayers would pay tax only at the 14-percent tax rate. For them the passage of H.R. would represent a 30-percent tax reduction. Another 10 percent would pay tax at only the 14- and 15-percent rates. They would receive an average percentage reduction in tax of between 25 and 30 percent. Still another 15 percent of all taxpayers would be subject to a rate no higher than 16 percent, or an average reduction of 25 percent.

The new tax rates on income in brackets above the present first taxable income bracket up to a taxable income of \$100,000 for a married couple will be 14 to 17 percent below present rates. But since these taxpayers also share in the reductions in lower brackets, the average tax reduction even for these levels is about 16 percent to 18 percent. The new rates on taxable incomes in excess of \$100,000 will show reductions of 17 percent to 23 percent below present rates. The top rate will be 21 percentage points less than the current maximum of 91 percent, a reduction of 23 percent.

The present top bracket rates were originally enacted to insure an equitable distribution of the sacrifices required by an all-out war effort. They are unrealistic today. Although individuals expend their best efforts and take investment risks for many reasons, the financial reward is an extremely important, if not critical, one. Reduction of the highest tax rates should, therefore, stimulate risk taking and effort, to the benefit not only of the taxpayers involved but to the entire economy as well. Moreover, a reduction in the highest rates will make it less rewarding for some of our most productive citizens to expend their energies in activities and planning designed to avoid the consequences of the present high tax rates. Finally, cuts in these high brackets will lose little revenue since few people actually pay these rates.

#### B. CORPORATE TAX RATES

The House bill reduces combined corporate normal and surtax rates from 52 percent to 50 percent in 1964 and 48 percent in 1965. Reversal of the historic trend toward high taxes will greatly improve business expectations and create more favorable conditions for new investment. When the rate reductions are fully effective, corporate income tax liabilities will be reduced by \$2.2 billion a year.

The reduction of corporate rates is an essential step in the continuing objective of stimulating economic growth. By raising profitability rates, greater incentives are provided for modernization of facilities and expansion of productive capacity. At the same time additional funds are supplied internally to finance expansion plans. To these reductions must be added the annual tax savings of \$2.25 billion resulting from the recent reduction in useful lives for depreciation purposes and the enactment last year of the investment credit. As a result of these measures American business will be in an unusually favorable position to expand.

##### 1. Benefits to small business

The proposed corporate rate structure is designed to give important tax benefits to small businesses. The House bill reduces the normal rate from 30 to 22 percent on the first \$25,000 of taxable income. In effect, the taxes of a business with income under \$25,000—a group that includes 467,500 out of 576,000 taxpaying corporations—will be reduced by 26.7 percent, against a reduction of 7.7 percent for very large companies. (See table 5.) The tax structure will thereby strengthen the internal financing of small businesses that have less ready access to the capital markets and are more dependent on internal funds for new investment. The vitality of small business that is so essential to our competitive economy will thus be better assured. The over 9 million small

individual proprietorships will of course benefit from comparable reductions in individual income tax rates.

## 2. Current payment of corporate income tax

The House bill will ultimately place large corporations on a current payment basis as in the case of individuals. It proposes a shift toward quarterly payments of tax in the corporation's taxable year. Corporations with tax liabilities in excess of \$100,000 will be required to make first and second quarterly current payments of 1 percent each in 1964, the quarterly percentages increasing to 4 percent in 1965, 9 percent in 1966, 14 percent in 1967, 19 percent in 1968, 22 percent in 1969, and finally 25 percent in 1970. Through this plan, by 1970 tax payments of all large corporations would be fully current, with 25 percent of this year's tax liabilities in excess of \$100,000 paid in each quarter. Payment requirements would be subject to the relief provisions of present law.

The corporations involved should experience no difficulty in adjusting to the current payments schedule. Because no payments would be required on the first \$100,000 of tax liabilities, its effects would be limited to 15,000 or so large corporations and only a small proportion of those companies would have substantial accelerated payments to make. The 15,000 large corporations account for about 2½ percent of the total number of corporations.

Many of the larger companies that will be subject to the full effect of accelerated payments conventionally fund their tax liabilities by investment in Treasury tax notes and other short-term securities. In general, then, the accelerated payments would not disturb their net working capital. Current payments would liquidate accrued income taxes payable and, therefore, reduce short-term liabilities by an equivalent amount.

The payment system of the bill is so designed that no corporation would make greater payments in any one year than under present law since the reduced tax liabilities resulting from lower tax rates would offset acceleration of tax payments.

## IV. STRUCTURAL REVISIONS

### A. INDIVIDUAL INCOME TAX

#### 1. Measures to relieve hardships and inequities

H.R. 8363 contains a number of provisions in the individual income tax area that provide relief for individuals and families at the lowest income levels, including many older persons. It would also remove inequities the existing tax system imposes on persons whose incomes fluctuate widely from year to year. The revenue cost of these provisions is \$435 million. Unless otherwise noted, these revisions would go into effect on January 1, 1964. They are designed to meet tax hardships which cannot be alleviated by rate reductions alone.

(a) *The minimum standard deduction.*—The bill provides each taxpayer with a minimum standard deduction of at least \$300 plus an additional \$100 for each exemption after the first. A married couple with no dependents would thus have a \$400 minimum standard deduction, or \$200 each if they filed separately. The standard deduction would still be optional, of course, and the taxpayer will still be free to itemize his deductions. The maximum limit to the standard deduction of \$1,000 will continue to apply regardless of the number of exemptions.

The minimum standard deduction is a far less costly and much more effective method of providing relief for those with low incomes than an increase in the personal exemption. Moreover, since it involves an adaptation of the familiar standard deduction, it is a recommendation readily effected and understood.

The minimum standard deduction would relieve many persons whose incomes are near subsistence levels of the tax liabilities they may incur under present law. A single person under 65 would not be subject to income tax until his income exceeds \$900, whereas at present he may be taxed on income in excess of \$687. For a single person with an income of \$900, the minimum standard deduction is equivalent to an increase in the personal exemption of over \$233. A married couple with income of \$1,000 would not be taxed whereas they now may be taxed on income in excess of \$1,333—for them the standard deduction is equivalent to an increase of \$133 per exemption. A married couple with two children would remain free of tax until their income exceeded \$3,000, as compared to their present nontaxable level of \$2,687. Such a married couple with two children would be granted the equivalent of an increase of \$83 per exemption.

Since the minimum standard deduction bases relief upon the number of exemptions, it grants additional relief to the very poor aged or blind. For ex-

ample, a widow aged 65 or more is not under this provision taxable on an income, not counting her nontaxable social security benefits, of less than \$1,600 a year. An older married couple would be exempt from tax on an income, again excluding social security benefits, of \$3,000 a year or less. The minimum standard deduction will, therefore, greatly help those of our Nation's older taxpayers who must live on low incomes.

The revenue cost of this provision is estimated to be \$320 million a year. Almost all of the tax saving would be granted to taxpayers with incomes of less than \$5,000.

(b) *Liberalization of the deduction for the care of children and disabled dependents.*—The bill will modify the present deduction for the expenses of child care and the care of dependents unable to look after themselves so as to make it more equitable and more meaningful. The bill raises from \$600 to \$900 the maximum deduction in the case of widows, widowers, and persons with disabled spouses when such people have two or more children or other eligible dependents to support. It also raises the age limit from 11 to 12 for children of the taxpayer for whom the deduction may be claimed. The bill grants the deduction to a man whose wife is incapacitated or institutionalized.

The annual revenue cost of these changes would be \$5 million a year.

(c) *Income averaging.*—H.R. 8363 provides a practical and uniform solution to the longstanding problem of the inequitable treatment that a progressive tax system can impose on individuals with receipts of income bunched in 1 year. Present law contains a variety of complex schemes applicable to limited situations.

Under this bill, taxpayers could average the amount of current income in excess of 133 $\frac{1}{3}$  percent of average income for the immediately preceding 4 years, provided the excess is over \$3,000. The tax on the income subject to averaging would be five times the tax payable on one-fifth of the amount. Capital gains, already subject to special tax provisions, are not eligible for the averaging provision. Neither may the provision be used to reduce the tax which would otherwise be due on wagering gains.

The provision would reduce revenues by \$40 million.

(d) *More liberal treatment of employee moving expenses.*—Under existing law a transferred employee may generally exclude from his gross income sums reimbursed by his employer for the basic expenses of moving to a new permanent duty station. Similar allowances received by a newly hired employee may not be so excluded, nor is any deduction allowed to any employee for nonreimbursed expenses.

The House bill provides a new moving expense deduction which will be available under certain conditions to all employees, whether newly hired or transferred, whose expenses are not excluded from income under present law. The deduction is allowable in computing adjusted gross income, so that employees who elect the standard deduction may also claim this new deduction. The deduction includes the reasonable expenses of moving household goods and personal effects and of family travel between the old and the new residence. (The deduction would not be allowed to a transferred employee who excludes reimbursements for moving expenses under present law.) By allowing this new deduction for moving expense, the bill removes the discrimination in present law in favor of reimbursed transferred employees. It would also promote the mobility of labor and thus enhance employment.

The estimated annual revenue cost is \$60 million.

(e) *Liberalization of the medical expense deduction for the aged.*—Under present law a taxpayer over 65 may deduct all of the medical expenses of himself or his spouse except in the case of the cost of medicines and drugs where his deduction is limited to the amount in excess of 1 percent of adjusted gross income. The bill eliminates this 1-percent floor for a taxpayer aged 65 or over for the expenses of medicines and drugs for himself or his spouse. The medical expenses of our senior citizens are much heavier on the average than similar expenses for younger persons and they may often include large amounts for medicines and drugs. The present 1-percent floor on the deduction would also be removed in the case of taxpayers who pay expenses for medicines and drugs on behalf of aged dependent parents.

The revenue cost of this provision is \$10 million.

(f) *Liberalization of the deduction for charitable contributions.*—Under present law, individuals are permitted to deduct the amount of their contributions to charitable organizations up to a limit of 20 percent of their adjusted gross income. Deductions amounting to an additional 10 percent of adjusted gross

income are permitted for contributions to churches, educational institutions, and medical and research facilities.

The bill would also make the present limitation more uniform and more liberal, extending the 10 percent additional deduction to donations to nonprofit organizations which are publicly supported and controlled. Such organizations would include community chests, health organizations such as the Cancer Society, the Red Cross, museums, symphony orchestras, etc. It would not include contributions to private foundations and trust funds.

Although very important to many philanthropic organizations, the revenue cost of this provision is expected to be nominal.

## 2. Base broadening and equity

The remaining provisions affecting the individual income tax are ones which would raise revenue. The measures are vital to the bill, for without the \$1 billion they would raise, rate reductions of the magnitude proposed would not be possible within the limits of fiscal prudence. Furthermore, these provisions improve tax equity, so vital to our system of voluntary compliance, by removing unwarranted special provisions and unnecessary complexities and inequities.

(a) *Restriction of the deduction for State and local taxes paid.*—Under the single largest base-broadening measure contained in H.R. 8303 the deduction for nonbusiness taxes paid would be limited to State, local, and foreign income and real property taxes, and State and local personal property and general sales taxes, including compensating use taxes. The provision would not affect taxes incurred in carrying on a business or producing income, which would remain fully deductible.

The bill, in effect, prohibits the deduction of State and local taxes on cigarettes, liquor, and gasoline, license fees on motor vehicles and operators' permits, and miscellaneous taxes such as admissions or occupancy taxes. Although eliminating the deduction for these items will produce a relatively large amount of revenue, it will have a minor impact on the average taxpayer because the burden is widely dispersed.

Limiting the deduction for taxes as provided would be an important step forward in tax equity. Under present law the deductibility of special taxes often depends on the form rather than the substance of the tax. Cigarette taxes, for example, are only deductible if they are levied directly on the consumer, or separately stated and passed on to him at the retail level. As a result, cigarette taxes are currently deductible for residents of 26 States and are not deductible in 21 States. Three States have no cigarette taxes.

This provision would simplify preparation of returns because the taxes in question are typically estimated on the basis of incomplete records or no records at all. It would eliminate present confusion over the relation between the legal form of the tax and its deductibility. The unprecise nature of the deductions claimed for these taxes not only makes it difficult for taxpayers to derive fair benefits from the deduction, it also makes it difficult for the Internal Revenue Service to audit claims.

Certain excise taxes now deductible are, in effect, payments for special benefits provided the users of special facilities. For example, in 1961, 96 percent of the \$3.5 billion collected from State motor fuel taxes was allocated to highway construction and maintenance. Like the Federal gasoline tax, which is non-deductible, these State motor fuel taxes form part of the price for the use of the highways. In the same manner that toll charges on highways and fees paid for the use of State parks are not now deductible, gasoline taxes paid for the personal use of highways should not be deductible.

This provision of the bill would provide \$520 million in additional revenues, which makes it the largest single base-broadening provision in H.R. 8303.

(b) *Repeal of dividend credit and increase of dividend exclusion.*—Present law provides an exclusion from taxable income of the first \$50 of dividend income (\$100 for a married couple where each has \$50 or more of dividend income) and a credit against tax liability of 4 percent of dividends which exceed \$50. The House bill would reduce the tax credit to 2 percent, effective in 1964, and eliminate it in 1965. The bill would increase the amount of exclusion to the first \$100 of dividend income (\$200 for a married couple), effective in 1964.

The House action is necessary to justify the rates adopted for middle and upper income brackets. The net revenue gain from the House action is estimated at \$120 million in 1964 and \$300 million in 1965. The repeal of the credit would gain \$370 million but would be offset somewhat by the higher exclusion which would cost \$70 million.

The \$50 exclusion was enacted in 1954 primarily for the benefit of very small



shareholders. It presently eliminates completely the taxation of dividends for 2 million filers. The House-adopted \$100 exclusion would remove from taxation the dividends of another 1 million taxpayers. Under the bill, a married couple would have to have more than \$6,000 of stockholdings before their dividends (\$200) would be at all taxable, on the basis of the current average dividend yield of 3.2 percent. For the vast majority of our citizens such an investment represents a sizable amount.

In addition to the 1 million taxpayers whose dividends will become completely tax free under the House bill, a further 1 million taxpayers will receive more tax relief from the additional \$50 exclusion (or \$100 for a married couple) than they do from the present 4 percent credit. At a tax rate of 20 percent, for example, dividends would have to exceed \$300 before a single taxpayer would no longer benefit more from the additional exclusion than the credit, and his stockholdings would generally be in excess of \$9,375. In the case of a married couple filing jointly the comparable figures would be dividends of \$600 on holdings valued at \$18,750.

Even for taxpayers with all of their income from dividends, the loss of the dividend credit is offset in practically all cases by the reduction in personal income tax rates. In the very few cases where this does not occur the increased dividend payments which corporate income tax reduction will produce, will still insure an increase in after-tax income. Thus all dividend recipients will be better off under the bill than they are today.

The 4-percent credit, enacted in 1954, sought to provide relief from so-called double taxation and to stimulate equity financing relative to debt financing, and thus promote economic growth. There is no clear evidence to indicate that the dividend credit increased equity financing and investment. Indeed, the ratio of equity to long-term debt financing fell from 77.3 percent in 1950 to 72.7 percent in 1960. Since 1954 the economy's growth rate has not been impressive.

As for the double-taxation relief the dividend credit provides, its benefits accrue to taxpayers in a very inequitable fashion. For example, as shown in table 3 of the attached exhibit 3 (under proposed rates), the lowest income bracket obtains relief from 4.3 percent of the extra burden the corporate tax allegedly imposes; the highest bracket enjoys a 12.2-percent relief. The existing dividend credit therefore provides the greatest benefits to high-income individuals. The 4-point reduction in the corporate tax, however, would remove 7.7 percent of the corporate tax burden from all stockholders—rich and poor. It is a much more straightforward and fair way of providing investors some measure of tax relief.

The revenue gain from the House provision is \$300 million.

(c) *The sick pay exclusion.*—Employees who are absent from work because of illness or injury and who continue to receive wages or salaries under employer-financed wage or salary continuation plans (commonly known as sick pay) under present law may exclude from income subject to tax up to \$100 a week of amounts so received. The wage exclusion is unrelated to hospital or medical costs which are excluded from income anyway if employer financed or subject to the medical expense deduction if paid by the employee. The wage exclusion applies from the first day the employee is injured or hospitalized; otherwise there is only a 7-day waiting period.

As the law now operates, wage continuation payments are very often excluded from income because of minor illness or injury. This means an employee who stays at home because of a slight injury which requires little or no medical care and still gets his salary or wages may exclude from income up to \$100 a week of his pay. His coworker, similarly injured, but who stays on the job, enjoys no such exclusion.

The House bill restricts the exclusion to cases of absences due to more prolonged and, hence more serious, illness or injury. The present \$100 a week exclusion would continue to apply but only after an employee has been absent from work for 30 calendar days, whether or not he is injured or hospitalized.

The revenue gain from the House provision would be \$110 million.

(d) *Minor casualty losses.*—The justification of the nonbusiness casualty loss deduction is similar to that for the medical expense deduction. The two adjust ability to pay for tax purposes to take into account extraordinary, nonrecurring losses of a type likely to be so large and unexpected that they inflict unusual hardship on the taxpayer. A certain amount of minor loss or damage is common to everyone's experience and should be treated as a part of ordinary living expenses. The fact that most individuals are prepared financially to meet these minor losses is well attested by the popularity of deductible clauses in automobile insurance policies.

It is estimated that enactment of this provision will increase revenues by \$50 million a year.

(c) *Group term life insurance and bank loan insurance.*—Present law does not require employees to include in their taxable income compensation received in the form of protection provided by employer-financed group term life insurance. Employers, however, may deduct such premiums as a business expense. This is the only kind of employer-financed life insurance which is not included in employee income. Within recent years, widespread use of this exclusion privilege has developed beyond its original purpose. The provision of "jumbo" group term insurance coverage for high-income executives has become a rather common method of providing substantial tax-free compensation for services. In some cases executives have enjoyed, without paying any tax on the premiums, the benefit of life insurance coverage of close to \$1 million, which protects their families and may substantially augment their estate.

H.R. 8303 would place a dollar limit on the amount of group term life insurance which can be enjoyed free of tax. An employee would be required to include in income for tax purposes the cost of group term life insurance protection provided by his employer to the extent the protection exceeds \$30,000. If the employee makes contributions toward the insurance, such contributions will be attributed to the amount of insurance protection which exceeds \$30,000. The amount to be included in income may be computed from simple tables constructed on a very favorable basis.

The bill exempts retired employees from this provision. It will affect less than 1 percent of those employees now receiving group-term life insurance protection from their employers.

Abuses have also developed in connection with arrangements which permit a taxpayer to purchase a life insurance, annuity, or endowment contract almost wholly with borrowed funds. Under such an arrangement the policyholder begins immediately to borrow substantial amounts against the cash value of the policy to pay premiums, and claims a tax deduction for the interest paid on such loans. The device takes advantage of interest deductibility, while the corresponding buildup on the reserves in the policy is not currently taxed and can escape all income tax.

The bill contains a provision which will effectively control these abuses. The provision is consistent with section 264 of present law, which disallows a deduction for interest on indebtedness incurred or continued to purchase or carry a single-premium life insurance, annuity, or endowment policy. The bill would not affect the normal use of life insurance policies as collateral for loans.

It is estimated that the two provisions described here will increase revenues by \$15 million a year.

(f) *Personal holding companies.*—The House bill would curb the use of personal holding companies to shelter passive investment income and certain personal service income from tax at individual income tax rates.

Present law permits a taxpayer to shelter such passive income (which in the case of dividends would be taxed under the House bill at corporate rates as low as 8.3 percent and not more than 7.2 percent) in a closely held corporation which has as little as just over 20 percent of its gross income from an active business. Since the active business need have no net income, a small investment in a business where expenses wash out income can save today as much as 82.5 percentage points of individual tax on sheltered portfolio investments. The House bill increases to just over 40 percent the proportion of gross income required to be derived from an active business to avoid personal holding company status. It also tightens the definition of personal holding company income in the areas of rentals, royalties, and capital gains to outlaw devices that have been frequently used to shelter portfolio investment income.

The House bill affords generous relief provisions to permit companies adversely affected by the changes to adjust their affairs.

The revenue gain from the changes in taxation of personal holding companies is estimated at \$15 million.

(g) *Gifts of future interests.*—The bill denies the charitable contribution deduction in the case of certain gifts of future interests which involve tangible personal property. This provision, for example, would prevent a taxpayer from claiming a charitable deduction in the year in which he donates some item of tangible personal property, most frequently paintings or other art objects, to a charitable institution such as a museum, if he continues to retain possession and enjoyment of the property for a period other than that of his life or the life of his spouse. In these cases the deduction will only be permitted when the property is actually transferred to the receiving institution.

The revenue gain from this provision is nominal.

## B. THE CORPORATE INCOME TAX

*1. Multiple surtax exemption*

Certain structural changes are essential to limit the benefits of lower normal tax rates to their intended purpose of aiding small businesses. Many large enterprises are exploiting the competitive advantage designed for small business by operating through multiple corporate units and obtaining numerous surtax exemptions of \$25,000. Exhibit 13 illustrates cases where several hundred outlets of the same business were separately incorporated, thereby often substantially reducing the effective rate of tax for the business. As a result of this practice the Federal income taxes of these businesses are appreciably below those paid by competitive enterprises of a comparable size which operate through a single corporation. They are at the same time endangering the continued existence of the small, independent firm by this tax advantage. Since the proposed change in corporate rates would provide even greater relative tax advantages, effective measures are urgently needed to restrict the use of the surtax exemption by multiple corporate groups under the same ownership and control.

Continuation of tax benefits to multicorporate enterprises cannot be condoned simply because in some cases they were formed for valid business and legal reasons rather than for tax avoidance. That tax benefits may not have been the main or only purpose in these cases should not be allowed to obscure the fact that the tax benefits of multiple surtax exemptions are very substantial and are not warranted by the underlying purpose of the surtax exemption. These multicorporate groups do not experience financial impediments similar to those experienced by the small corporations which the surtax exemption is designed to aid. Even where for legal reasons separate incorporation of the units may be required, the economic and financial resources of multicorporate groups are equal to those of its combined members or a comparable large single corporation. Hence it is paradoxical that a feature of the tax law designed to aid small firms serves to enhance the financial well-being and strength of their large multicorporate competitors.

The bill meets this problem by imposing additional taxes on the taxable income of affiliated corporations that do not file consolidated returns and elect to retain multiple surtax exemptions. The additional tax rates would be 6 percent on the first \$25,000 of income.

Although the provision does not fully eliminate the unwarranted tax advantages of multicorporate organizations, it generally precludes increasing those advantages through the proposed reduction in the normal tax rate designed to assist independent small business.

Enactment of these proposals would add an estimated \$35 million to tax receipts.

*2. Two-percent tax on consolidated returns*

Affiliated corporations filing consolidated returns are now subject to an additional 2-percent tax on their consolidated net income. The House bill provides for the repeal of this additional tax.

Repeal of the 2-percent tax is consistent with the treatment of affiliated corporations as an economic unit. Its repeal, therefore, should be contingent upon the adoption of the proposals concerning multiple surtax exemptions for commonly controlled corporations. Elimination of the 2-percent tax on consolidated returns will then facilitate the transition of multicorporate structures to more rational taxation and permit the lower rates on small business.

Enactment of this provision would reduce Federal revenues by \$50 million.

*3. The aggregation of oil and gas properties*

Prior to 1954, taxpayers were permitted to combine certain mineral deposits in a tract or parcel of land for the purpose of computing the net income limitation on the deduction for percentage depletion. This practice did not work satisfactorily in the case of some hard minerals, such as coal, and the law was amended in 1954 to permit other forms of property grouping if the properties were in one "operating unit." While the change was brought about by the problems of the hard minerals industry, it was also made applicable to the oil and gas industry although that industry did not request any change. The grouping practices that have evolved in the oil and gas industry as a consequence of the 1954 legislation have been used to minimize taxes in a way that does not seem to have been contemplated by the 1954 legislation and does not accord with sound and ordinary business practices in the industry. It is these undesirable grouping practices induced by the 1954 legislation that should be

curbed. A company able to select and combine high cost with low-cost properties located over wide geographical areas, including some properties and excluding others as best suits its tax picture, can readily circumvent the application of the 50-percent net income limitation. The excess net income from profitable properties is used to increase the lower net income or losses on other properties with the result that none of the properties is affected by the 50-percent limitation. As a result larger percentage depletion allowances may be taken.

In general, H.R. 8363 restores the pre-1954 rules governing the grouping of operating mineral interests in the case of oil and gas properties for taxable years beginning after December 31, 1963. It provides that oil and gas operators may elect to maintain separate deposits as separate properties or may combine some or all deposits falling within a single tract or parcel of land. It also provides that interests participating under a unitization agreement will be treated as one property even though included in different tracts of land.

Primarily larger operators with widely scattered holdings will be affected by the aggregation proposal. The information available to the Treasury indicates that most small operators in the oil and gas industry have not used the broad aggregation rule and thus would not be affected by its elimination. For instance 90 percent of this provision's estimated revenue gain (of \$40 million) is attributable to the 32 largest producers. The aggregation proposal does not affect producers of minerals other than oil and gas.

## V. CAPITAL GAINS

### A. BASIC PROVISIONS

Under present law 50 percent of the net capital gains of individuals on assets held more than 6 months are includible in income subject to tax at the regular rates, except that the tax may not exceed 25 percent on such net gains in any event. Thus the general rate reduction of the House bill automatically reduces the tax on long-term capital gains for all those below a 50-percent marginal tax rate, at which point the 25-percent ceiling takes hold. Under the House bill this marginal rate starts at \$44,000 of taxable income for a married taxpayer instead of \$32,000 under present law.

The House bill provides a further reduction for assets sold after a 2-year holding period. Only 40 percent of the gain on such assets would be included in income instead of 50 percent and the maximum tax would be 21 percent instead of 25 percent. Capital gains on assets held more than 6 months but not more than 2 years would continue to be includible at 50 percent with a maximum tax of 25 percent. The so-called statutory capital gains—income not truly derived from the sale of capital assets, such as lump-sum distributions from pension plans, gain on cutting of timber inventories and the like—would remain in the 50-percent inclusion-25 percent maximum rate category. For those taxpayers not using the alternative rate—97 percent of all tax returns with capital gains—the combination of the reduction in the inclusion factor and the lower ordinary income rates affords a 35-percent reduction in tax on capital gains as opposed to a 19-percent reduction on ordinary income.

These capital gain provisions of the House bill are unacceptable. They provide a rate reduction which will largely benefit our wealthier citizens without treating a concomitant problem of equity in capital gains taxation, namely that gains which are unrealized at the time of death are never subject to income taxes. A man who accumulates an estate from salary or dividends, or business profit, pays income tax on the accumulation during his lifetime and then if the estate is large enough, his estate may be liable for estate tax when he dies. The same is true of a man who builds up a valuable business and sells it before he dies.

However, the individual who holds appreciated assets until death, as well as his heirs, escape all income and capital gains tax applicable to their gains, since the tax cost or basis to the heir is stepped up to the value of the property in the gross estate of the decedent. This situation is not only a special benefit to owners of capital assets, but it seriously "locks-in" capital holdings. Indeed, it may be a principal cause of the "lock-in" problem for which other remedies are suggested. Older taxpayers frequently feel they "can't afford" to sell appreciated capital assets when they know that the capital gains tax can be completely avoided by keeping the asset in their hands and then passing it to their heirs.

The President specifically stated in his tax message last January that no reduction in the capital gains rate of taxation is justified unless a tax is imposed

"at capital gains rates on all net gains accrued on capital assets at the time of transfer at death or by gift." The Ways and Means Committee had substituted a tentative provision for carryover of a decedent's basis at death which was reasonably satisfactory, since it meant that the capital gains tax on the before-death appreciation would be paid when the property was sold by the heir. At the last moment, however, the Ways and Means Committee decided to delete the provision because it was dissatisfied with the language presented to it and wanted more time to work out technical details. Without a provision either for carryover of basis or for taxation at the time of transfer at death, the capital gains rate changes should be deleted from the House bill and the entire matter put over until the problem can be solved as a whole. Without closing the escape hatch by which our wealthier taxpayers can avoid all taxation on substantial amounts of capital gains, there is no justification for a reduction in rates of primary benefit to such taxpayers. The present 50 percent inclusion factor and 25 percent ceiling provide enough of an advantage for those whose income is derived from profits on the sale of capital assets. Moreover, since the House provisions involve a three-step arrangement of capital gain inclusions and two maximum rates, they seriously complicate the capital gain portion of the tax return and of the code.

The deletion of this feature would lower the longrun annual revenue loss by about \$140 million. We would, however, have to forgo a temporary 2-year increase in revenues during fiscal 1965 and 1966, which had been foreseen because of the initial one-time "unlocking effects" of the reductions in capital gain tax rates. These revenue effects are shown in detail in table 6.

## B. OTHER CAPITAL GAINS PROVISIONS

### 1. Gains on the sale of depreciable real estate

The House bill deals with the sale of real estate at a gain after the taxpayer has taken advantage of the accelerated methods of depreciation allowed under present law. (The provision is necessary to curb the single most serious abuse that has arisen in the sale of real property—the conversion of ordinary income to capital gain by early sale after use of fast depreciation. Under the bill, if a building is sold within 1 year after its acquisition, any gain up to the amount of post-1963 depreciation taken on the building is to be treated as ordinary income. If the building is sold during the first 8 months of the second year, gain is to be treated as ordinary income to the extent of the excess of depreciation taken over straight-line depreciation. Beginning with the 21st month after acquisition, the excess of actual depreciation taken over straight-line depreciation which is to be treated as ordinary income will be diminished by 1 percent per month. After 10 years, any gain will be treated as a long-term capital gain except that major improvements are to be treated as having a separate holding period.)

It is estimated that this provision would increase revenues by \$15 million a year.

### 2. Stock options

The House bill imposes certain new limitations on the capital gains tax treatment of benefits arising from executive stock option plans. First, the bill provides that stock purchased pursuant to option must be held for a period of 3 years following the exercise of the option, if the spread between the market value at the time of exercise and the option price is to be treated as a capital gain. Under present law, the stock need be held only 6 months after exercise or 2 years from grant. This has encouraged quick sales and speculative profits, contrary to the incentive purpose of the stock option provisions.

Next, the bill provides that an option may be outstanding for no more than 5 years (instead of 10 as under present law) to qualify for special treatment, and if the price of the stock declines in this period, the option price may not be reduced. These provisions will encourage the early acquisition of a proprietary interest by the employee and will insure that the employee will only profit at times when the price of the stock is higher than at the time of the original grant.

The bill also provides that the option must be issued at 100 percent of market value, not at some level below market value as under present law. Also, with the exception of corporations whose net worth is less than \$2 million, no employee who owns 5 percent or more of the stock in a corporation will be eligible for capital gains treatment on stock option benefits. There is no need to provide an ownership incentive for employees who are already substantial stockholders. Others provisions are set forth in the report accompanying the House bill.

The bill continues the treatment of present law in the case of nondiscriminatory employee stock purchase plans. The revenue effect of the stock option provisions will be nominal.

### 3. *Interest on deferred payments*

The bill contains a provision which will curb abuses in cases in which assets are sold by means of deferred, or installment, payments. At present, when the interest in installment payments is shown separately, it is taxed as ordinary income to the seller and is deductible by the buyer. However, the seller may convert the interest payments to capital gains by simply failing to specify the interest as a separate component of each installment and calling the payments noninterest bearing. Frequently the designation of interest is immaterial to the buyer, who may deduct the whole purchase price anyway as depreciation, or may be tax exempt.

The bill provides that if the sales contract does not specify an adequate amount of interest, a part of the proceeds will nevertheless be treated as interest and will be taxed as ordinary income. The provision will not apply to annuities or to patent royalties.

The revision will not have any appreciable revenue effect.

### 4. *Gain on the sale of a residence by an older taxpayer*

H.R. 8363 exempts from income subject to tax certain gains arising from the sale or exchange of a residence by an individual who has attained the age of 65. Aged persons could exclude completely any gain from the sale of their principal residence if the sales price of the house is less than \$20,000. If the sales price is higher than \$20,000 a percentage of the gain can be excluded from the income equal to the ratio of \$20,000 to the actual sales price. The taxpayer must have used the property as his principal residence for 5 out of the preceding 8 years and may not have used the provision previously.

This provision would reduce revenues by \$10 million a year.

### 5. *Iron ore royalties*

The bill would include iron ore royalties in the class of items which, though involving ordinary income receipts, are however to be taxed at lower capital gains tax rates.

This provision will reduce revenues by \$5 million a year.

### 6. *Indefinite loss carryover*

Present law permits an individual to deduct up to \$1,000 of net capital loss from ordinary income in a given year, and to carry a larger capital loss over for a period of 5 years. As part of our proposed capital gains revisions, we proposed that the \$1,000 annual carryover be indefinite in duration. The House bill accepted this proposal. Although I have indicated our objections to the capital gains tax reduction features of this bill, I believe this indefinite loss carryover should be retained. This benefits mainly small investors and property holders who do not have capital gains against which they can fully offset major losses. It would reduce revenue by \$30 million a year.

## VI. AMENDMENTS TO THE REVENUE ACT OF 1962

This bill also contains several provisions designed to improve or clarify the application of the investment credit adopted in 1962.

### A. DEPRECIATION ADJUSTMENTS FOR THE INVESTMENT TAX CREDIT

As a result of legislation approved by the Congress last year, tax liabilities of business firms in general are reduced by an amount equal to 7 percent of their outlays for new equipment. Annual tax savings for each firm may amount to as much as the first \$25,000 of tax liabilities plus 25 percent of the excess. However, the business must reduce the depreciation basis of the assets required by the amount of the credit. This requirement has led to a number of unforeseen accounting and administrative difficulties for both taxpayers and the Internal Revenue Service. The effectiveness of the credit has also been substantially reduced by the basis adjustment requirement.

H.R. 8363 eliminates the reduction in basis so that the benefits of the investment credit would not be reduced in the future, and so that the impairment already encountered would be recouped. The bill repeals the reduction in basis requirement for assets placed in use after June 30, 1963. It also provides that the amounts deducted from basis before July 1, 1963, may be added back

to basis as of the beginning of the first taxable year of the taxpayer which begins after June 30, 1963.

This provision is appropriately included in this bill, which is directed at improving the performance of the economy. The investment credit stimulates investment by reducing the net cost of acquiring depreciable assets, thereby increasing the all-important rate of profitability on a given investment outlay. The requirement that the basis for depreciation of assets be reduced by the amount of the credit taken cuts the inducement to new investment provided by the credit almost in half. When an investor appraises the profit potential of a new investment, he views taxes on income as a cost which reduces the net return. Whereas the tax credit reduces this tax cost and increases profitability, the resulting reduction in the depreciation base partially offsets the effect of the credit by reducing the amount of the depreciation which may be taken and thereby increasing the taxable income from the investment.

At corporate tax rates of 48 percent, repeal of the basis reduction provision will almost double the incentive provided by the present tax credit. By reducing business taxes it will increase the profitability of new investment and encourage the more rapid expansion and modernization of existing facilities. It will thereby give an important stimulus to economic growth.

Repeal of the reduction-in-basis provision will also eliminate a number of administrative problems and bookkeeping details which have burdened so many taxpayers, especially small businesses. For example, in most States taxpayers are not required to reduce their depreciation basis to reflect the investment tax credit when computing income for State tax purposes. Consequently, taxpayers in these States are now required to keep two different sets of accounts in which their various assets have different bases. In addition, the basis reduction complicates the computation of earnings and profits, the pricing of defense contracts, and the bookkeeping requirements of regulated companies. Finally, the fact that the basis reduction immediately reduces depreciation even in those cases where the taxpayer is not able to use the credit can result in a net detriment to the taxpayer until he can use the credit.

It is estimated that this provision will result in decreased tax liabilities of \$145 million in calendar year 1964 and \$185 million in calendar year 1965. Estimated reductions in fiscal year receipts are \$15 million in 1964 and \$145 million in 1965.

#### B. OTHER TECHNICAL CHANGES

The bill also makes three other changes in the investment credit.

(1) It extends the credit to new escalators and elevators installed after July 1, 1963. At the same time, escalators and elevators disposed of after December 31, 1963, are made subject to the depreciation recapture provision adopted in the Revenue Act of 1962. These provisions will reduce revenues by \$10 million.

(2) It provides that a lessee from a distributor may base his investment credit on the fair market value of the leased property rather than the lessor's cost. A lessee from a manufacturer may use fair market value under the present law.

(3) It expresses the intent of the Congress in enacting the investment credit as to its treatment by Federal regulatory agencies in setting rates for consumers.

#### CONCLUSION

In conclusion, Mr. Chairman, I wish to emphasize the urgent need for prompt action along the lines suggested by this bill to reduce taxes and strengthen the economy. We can no longer delay decisive action to restore the full measure of economic vigor, both because of the seriousness of the unemployment problem at home and because of our balance-of-payments problems. Reduced tax rates and the structural revisions adopted for equity purposes will increase the reward for effort, enterprise, and risk taking and will thus enhance individual initiative and stimulate investment. These factors will provide the needed spur to full employment and a faster rate of economic growth.

The revenue loss incurred in the first few years because of this bill will be only temporary. In combination with the program of strict expenditure control announced by the President, the stimulating effects of tax reduction on the economy should produce sufficient revenue gains in the future to enable us to balance the budget.

It is essential to the well-being of the Nation that every effort be made to complete action on this bill before the end of the current year. The encouraging expansion of economic activity which has occurred thus far during the year is no doubt in part the result of favorable speculation regarding tax reduction. Fail-

ure to act on this bill might produce adverse psychological reactions throughout the country which would check the growth of our economy. The Nation has waited too long for relief from the stifling burden of excess taxes. Although the problems placed upon Congress and this committee are many and pressing, nothing is more important to the health of the Nation than decisive and prompt action along the lines provided by this bill.

TABLE 1.—Comparison of individual income tax rates under present law and under the revenue bill of 1963

Taxable income bracket (in thousands of dollars)		Present rates	Revenue bill of 1963	
Single person	Married (joint)		1964 rates	1965 rates
		Percent	Percent	Percent
0 to 0.5.....	0 to 1.....	20	16.0	14
0.5 to 1.....	1 to 2.....	20	16.5	15
1 to 1.5.....	2 to 3.....	20	17.5	16
1.5 to 2.....	3 to 4.....	20	18.0	17
2 to 4.....	4 to 8.....	22	20.0	19
4 to 6.....	8 to 12.....	25	23.5	22
6 to 8.....	12 to 16.....	30	27.0	25
8 to 10.....	16 to 20.....	34	30.5	28
10 to 12.....	20 to 24.....	38	34.0	32
12 to 14.....	24 to 28.....	43	37.5	36
14 to 16.....	28 to 32.....	47	41.0	39
16 to 18.....	32 to 36.....	50	44.5	42
18 to 20.....	36 to 40.....	53	47.5	45
20 to 22.....	40 to 44.....	56	50.5	48
22 to 26.....	44 to 52.....	59	53.5	50
26 to 32.....	52 to 64.....	62	56.0	53
32 to 38.....	64 to 76.....	65	58.5	55
38 to 44.....	76 to 88.....	69	61.0	58
44 to 50.....	88 to 100.....	72	63.5	60
50 to 60.....	100 to 120.....	75	66.0	62
60 to 70.....	120 to 140.....	78	68.5	64
70 to 80.....	140 to 160.....	81	71.0	66
80 to 90.....	160 to 180.....	84	73.5	68
90 to 100.....	180 to 200.....	87	75.0	69
100 to 150.....	200 to 300.....	89	76.5	70
150 to 200.....	300 to 400.....	90	76.5	70
200 and over.....	400 and over.....	91	77.0	70

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 3, 1963.

TABLE 1A.—Comparison of schedules under present law and under the revenue bill of 1963

Taxable income bracket (in thousands of dollars)		Present law rate (percent)	Revenue bill of 1963	
Single person	Married (joint)		Rate (percent)	Percent of present rate
0 to 0.5.....	0 to 1.....	20	14	70
0.5 to 1.....	1 to 2.....	20	15	75
1 to 1.5.....	2 to 3.....	20	16	80
1.5 to 2.....	3 to 4.....	20	17	85
2 to 4.....	4 to 8.....	22	19	86
4 to 6.....	8 to 12.....	26	22	85
6 to 8.....	12 to 16.....	30	25	83
8 to 10.....	16 to 20.....	34	28	83
10 to 12.....	20 to 24.....	38	32	84
12 to 14.....	24 to 28.....	43	36	84
14 to 16.....	28 to 32.....	47	39	83
16 to 18.....	32 to 36.....	50	42	84
18 to 20.....	36 to 40.....	53	45	85
20 to 22.....	40 to 44.....	56	48	86
22 to 26.....	44 to 52.....	59	50	85
26 to 32.....	52 to 64.....	62	53	85
32 to 38.....	64 to 76.....	65	55	85
38 to 44.....	76 to 88.....	69	58	84
44 to 50.....	88 to 100.....	72	60	83
50 to 60.....	100 to 120.....	75	62	83
60 to 70.....	120 to 140.....	78	64	82
70 to 80.....	140 to 160.....	81	66	81
80 to 90.....	160 to 180.....	84	68	81
90 to 100.....	180 to 200.....	87	69	79
100 to 150.....	200 to 300.....	89	70	78
150 to 200.....	300 to 400.....	90	70	79
200 and over.....	400 and over.....	91	70	77



TABLE 2.—Revenue bill of 1963—H.R. 8363: Estimated decrease in revenue<sup>1</sup> (—) and increase (+) (before feedback) or provisions<sup>2</sup> of bill

[In millions of dollars]

	Calendar year 1964 Liabilities			Calendar year 1965 Liabilities <sup>2</sup>		
	Individual <sup>3</sup>	Corporate	Total	Individual	Corporate	Total
<b>A. 1963 tax program:</b>						
Rate changes.....	-6,310	-1,320	-7,630	-9,470	-2,190	-11,660
Structural changes:						
(a) Revenue raising:						
1. Group term insurance.....	+5	-----	+5	+5	-----	+5
2. Bank loan insurance.....	+5	-----	+5	+10	-----	+10
3. Sick pay exclusion.....	+110	-----	+110	+110	-----	+110
4. Deduction of personal taxes.....	+520	-----	+520	+520	-----	+520
5. Casualty loss deduction.....	+50	-----	+50	+50	-----	+50
6. Aggregation of mineral properties.....	-----	+40	+40	-----	+40	+40
7. Personal holding companies.....	+15	-----	+15	+15	-----	+15
8. Repeal of dividend credit and increase in exclusion.....	+120	-----	+120	+300	-----	+300
9. Multiple corporation penalty tax.....	-----	+35	+35	-----	+35	+35
10. Gifts of future interest.....	(*)	-----	(*)	(*)	-----	(*)
Total, revenue raising.....	+825	+75	+900	+1,010	+75	+1,085
(b) Revenue reducing:						
11. Medical expense deduction.....	-10	-----	-10	-10	-----	-10
12. Child care allowance.....	-5	-----	-5	-5	-----	-5
13. Moving expenses.....	-60	-----	-60	-60	-----	-60
14. Income averaging.....	-40	-----	-40	-40	-----	-40
15. Minimum standard deduction.....	-320	-----	-320	-320	-----	-320
16. Repeal 2-percent tax on consolidated returns.....	-----	-50	-50	-----	-50	-50
17. Charitable deductions.....	(*)	-----	(*)	(*)	-----	(*)
Total, revenue reducing.....	-435	-50	-485	-435	-50	-485
Total, structural changes.....	+390	+25	-415	+575	+25	+600
Total, rate and structural changes, 1963 tax program.....	-5,920	-1,295	-7,215	-8,895	-2,165	-11,060
Capital gains revision (including induced effects):						
1. Unlocking of capital gains from general rate reduction.....	+130	-----	+130	+130	-----	+130
2. 50-40 percent inclusion and 21 percent maximum rate.....	+210	-----	+210	+80	-----	+80
3. Sale or exchange of real estate.....	-----	(*)	(*)	+15	-----	+15
4. Carryover of losses.....	-30	-----	-30	-30	-----	-30
5. Sales of residences by taxpayers aged 65 or over.....	-10	-----	-10	-10	-----	-10
6. Capital gains treatment of iron ore royalties.....	-----	-5	-5	-----	-5	-5
7. Stock options.....	(*)	-----	(*)	(*)	-----	(*)
Total, capital gains revision.....	+300	-5	+295	+170	+10	+180
Total, 1963 tax program.....	-5,620	-1,300	-6,920	-8,725	-2,155	-10,880
<b>B. Revision of 1962 legislation:</b>						
1. Repeal of requirement to reduce basis by investment credit.....	-20	-125	-145	-25	-160	-185
2. Allow investment credit for elevators and escalators.....	-----	-10	-10	-----	-10	-10
Total, revision of 1962 legislation.....	-20	-135	-155	-25	-170	-195
<b>C. Total, revenue bill of 1963.....</b>	<b>-5,640</b>	<b>-1,435</b>	<b>-7,075</b>	<b>-8,750</b>	<b>-2,325</b>	<b>-11,075</b>

<sup>1</sup> At levels of income estimated for the calendar year 1963.

<sup>2</sup> As reported by the Ways and Means Committee.

<sup>3</sup> Long-term effect except for capital gains. Certain provisions would be different for actual 1965. Bank loan insurance would be +\$5,000,000 and sale or exchange of real estate, +\$5,000,000.

TABLE 3.—Revenue bill of 1963—Change in tax liability resulting from rate and structural changes<sup>1</sup> for individuals

Adjusted gross income class (in thousands of dollars)	Rate change	Structural changes										Total	Total	
		Group term and other insur- ance	Sick pay exclu- sion	Limita- tion of deduc- tions	Casualty loss deduc- tion	Personal holding com- panies	Dividend credit and exclu- sion	Medical care deduc- tion (aged)	Child care allow- ance	Moving expenses	Income averaging			Mini- mum standard deduc- tion
In millions of dollars														
0 to 3.....	-400	(?)	5	10	(?)	(?)	(?)	(?)	(?)	(?)	-----	-170	-155	-555
3 to 5.....	-1,020	(?)	20	50	5	(?)	30	(?)	(?)	-5	-15	-100	-35	-1,055
5 to 10.....	-3,905	(?)	55	220	25	(?)	30	(?)	(?)	(?)	-25	(?)	+255	-3,650
10 to 20.....	-2,285	(?)	25	130	15	(?)	50	(?)	(?)	(?)	-15	-10	+195	-2,090
20 to 50.....	-1,150	5	5	60	5	(?)	85	-5	(?)	(?)	-5	-20	+130	-1,020
50 and over.....	-710	10	(?)	50	(?)	15	125	-5	(?)	(?)	(?)	-10	+185	-525
Total.....	-9,470	15	110	520	50	15	300	-10	-5	-60	-40	-320	+575	-8,895
Change as a percent of present tax														
0 to 3.....	-27.6	(?)	0.3	0.7	(?)	(?)	(?)	(?)	(?)	(?)	-----	-11.7	-10.7	-38.3
3 to 5.....	-25.3	(?)	.5	1.2	0.1	(?)	0.2	(?)	(?)	-0.1	-0.4	-2.5	-9	-26.2
5 to 10.....	-21.3	(?)	.3	1.2	.1	(?)	.2	(?)	(?)	(?)	-1	(?)	+1.4	-19.9
10 to 20.....	-18.0	(?)	.2	1.0	.1	(?)	.4	(?)	(?)	(?)	-1	-0.1	+1.5	-16.4
20 to 50.....	-17.0	0.1	.1	.9	.1	(?)	1.3	-1	(?)	(?)	-1	-3	+1.9	-15.1
50 and over.....	-17.0	.2	(?)	1.2	(?)	.4	3.0	-1	(?)	(?)	(?)	-2	+4.4	-12.6
Total.....	-20.0	(?)	.2	1.1	.1	(?)	.6	(?)	(?)	-1	-1	-7	+1.2	-18.8

<sup>1</sup> Excluding capital gains.<sup>2</sup> Less than \$2,500,000 or 0.05 percent.

TABLE 4.—Revenue bill of 1963—Distribution by adjusted gross income class of the full year effect of all tax changes<sup>1</sup> directly affecting individuals

Adjusted gross income class (in thousands of dollars)	Number of taxable returns (millions)	Tax liability under present law	Effect of revenue bill of 1963			Total tax under revenue bill of 1963
			Rate change	Structural changes	Total	
In millions of dollars						
0 to 3.....	9.7	1,450	-400	-155	-555	895
3 to 5.....	10.5	4,030	-1,020	-35	-1,055	2,975
5 to 10.....	22.9	18,300	-3,905	+255	-3,650	14,650
10 to 20.....	6.7	12,710	-2,285	+195	-2,090	10,620
20 to 50.....	1.0	6,760	-1,150	+130	-1,020	5,740
50 and over.....	.2	4,170	-710	+185	-525	3,645
Total.....	61.0	47,420	-9,470	+575	-8,895	38,525
Percent distribution by income class						
0 to 3.....	19.0	3.1	4.2	-27.0	6.2	2.3
3 to 5.....	20.6	8.5	10.8	-6.1	11.9	7.7
5 to 10.....	44.9	38.6	41.2	44.3	41.0	38.0
10 to 20.....	13.1	26.8	24.1	33.9	23.5	27.6
20 to 50.....	2.0	14.3	12.1	22.6	11.5	14.9
50 and over.....	.4	8.8	7.5	32.2	5.9	9.5
Total.....	100.0	100.0	100.0	100.0	100.0	100.0
Percent of tax liability under present law						
0 to 3.....		100.0	-27.6	-10.7	-38.3	61.7
3 to 5.....		100.0	-25.3	-.9	-26.2	73.8
5 to 10.....		100.0	-21.3	+1.4	-19.9	80.1
10 to 20.....		100.0	-18.0	+1.5	-16.4	83.6
20 to 50.....		100.0	-17.0	+1.9	-15.1	84.9
50 and over.....		100.0	-17.0	+4.4	-12.6	87.4
Total.....		100.0	-20.0	+1.2	-18.8	81.2

<sup>1</sup> Excluding capital gains.TABLE 5.—Revenue effect<sup>1</sup> of reducing corporate normal tax to 22 percent and combined rate to 48 percent

Surtax net income class	Number of taxable corporations	Computed tax liability, (present rates) <sup>2</sup> (millions)	Normal tax to 22 percent and combined rate to 48 percent	
			Amount of reduction (millions)	Percent reduction
0 to \$25,000.....	467,500	\$874	\$223	26.7
\$25,000 to \$50,000.....	54,000	636	126	19.8
\$50,000 to \$100,000.....	25,000	759	94	12.4
\$100,000 to \$1,000,000.....	25,500	3,427	299	8.7
\$1,000,000 and over.....	4,000	18,664	1,438	7.7
Total.....	576,000	24,360	2,190	9.0

<sup>1</sup> At 1963 levels of income.<sup>2</sup> Excluding capital gains presently taxed at the alternative rate.

**TABLE 6.—Effect of the House bill—50-40 percent inclusion, 21 percent alternative rate provision for 1964, 1965, 1966, 1967, and longrun tax liabilities**

[In millions of dollars; calendar years <sup>1</sup>]

	1964	1965	1966	1967	1968 and long run
Direct effects of reduced inclusion percentage and lower maximum rate.....	-230	-230	-230	-230	-230
<b>INDUCED EFFECTS</b>					
1. Unlocking of capital gains from reduced inclusion percentage and lower alternative rate.....	+520	+320	+195	+150	+100
2. Deferral effect on gains between 6 months and 2 years.....	-80	-10	-10	-10	-10
3. Total induced effects.....	+440	+310	+185	+140	+90
Total effects.....	+210	+80	-45	-90	-140

<sup>1</sup> Since the table shows tax liabilities incurred in calendar years, the numbers shown also constitute good estimates of receipts for the following fiscal years; e.g., the -\$45,000,000 total effect figure for calendar year 1966 equals the fiscal year 1967 revenue.

**TABLE 7.—Effective rates of tax applicable to capital gains**

Taxable income brackets		Gains of sale of assets held—				
		Present law		Revenue bill of 1963		
Single person	Married (joint)	Less than 6 months	6 months or more	Less than 6 months	6 months to 2 years <sup>1</sup>	2 years or more <sup>2</sup>
Thousands of dollars		percent				
0 to 0.5.....	0 to 1.....	20	10.0	14	7.0	5.6
0.5 to 1.....	1 to 2.....	20	10.0	15	7.5	6.0
1 to 1.5.....	2 to 3.....	20	10.0	16	8.0	6.4
1.5 to 2.....	3 to 4.....	20	10.0	17	8.5	6.8
2 to 4.....	4 to 8.....	22	11.0	19	9.5	7.6
4 to 6.....	8 to 12.....	26	13.0	22	11.0	8.8
6 to 8.....	12 to 16.....	30	15.0	25	12.5	10.0
8 to 10.....	16 to 20.....	34	17.0	28	14.0	11.2
10 to 12.....	20 to 24.....	38	19.0	32	16.0	12.8
12 to 14.....	24 to 28.....	43	21.5	36	18.0	14.4
14 to 16.....	28 to 32.....	47	23.5	39	19.5	15.6
16 to 18.....	32 to 36.....	50	25.0	42	21.0	16.8
18 to 20.....	36 to 40.....	53	25.0	45	22.5	18.0
20 to 22.....	40 to 44.....	56	25.0	48	24.0	19.2
22 to 24.....	44 to 48.....	59	25.0	50	25.0	20.0
24 to 26.....	48 to 52.....	62	25.0	53	25.0	21.0
26 to 28.....	52 to 56.....	65	25.0	55	25.0	21.0
28 to 30.....	56 to 60.....	67	25.0	57	25.0	21.0
30 to 32.....	60 to 64.....	69	25.0	58	25.0	21.0
32 to 34.....	64 to 68.....	71	25.0	60	25.0	21.0
34 to 36.....	68 to 72.....	72	25.0	61	25.0	21.0
36 to 38.....	72 to 76.....	73	25.0	62	25.0	21.0
38 to 40.....	76 to 80.....	74	25.0	63	25.0	21.0
40 to 42.....	80 to 84.....	75	25.0	64	25.0	21.0
42 to 44.....	84 to 88.....	76	25.0	65	25.0	21.0
44 to 46.....	88 to 92.....	77	25.0	66	25.0	21.0
46 to 48.....	92 to 96.....	78	25.0	67	25.0	21.0
48 to 50.....	96 to 100.....	79	25.0	68	25.0	21.0
50 to 55.....	100 to 120.....	80	25.0	69	25.0	21.0
55 to 60.....	120 to 140.....	81	25.0	70	25.0	21.0
60 to 70.....	140 to 160.....	82	25.0	71	25.0	21.0
70 to 80.....	160 to 180.....	83	25.0	72	25.0	21.0
80 to 90.....	180 to 200.....	84	25.0	73	25.0	21.0
90 to 100.....	200 to 300.....	85	25.0	74	25.0	21.0
100 to 150.....	300 to 400.....	86	25.0	75	25.0	21.0
150 to 200.....	400 and over.....	87	25.0	76	25.0	21.0
200 and over.....		88	25.0	77	25.0	21.0

<sup>1</sup> 50-percent inclusion. This column also reflects the effective rate on capital gains beyond a 2-year period if the 50-percent inclusion and the maximum 25-percent tax rate of the present law is retained in lieu of the capital gains features of the House bill.

<sup>2</sup> 40-percent inclusion.

*Exhibits*

Exhibit No.	Revenue bill of 1963, section No.	Description
1.....	112	The minimum standard deduction.
2.....	122	Current taxpayment for corporations.
3.....	201	The dividend credit and exclusion.
4.....	205	Modification of sick-pay exclusion.
5.....	207	Denial of deduction for certain State and local taxes.
6.....	213	Abuses of interest deduction when an individual uses borrowed money to purchase a life insurance policy.
7.....	214	The tax treatment of employee stock options.
8.....	216	Personal holding companies.
9.....	217	Grouping of oil and gas properties.
10.....	219	Treatment of capital gains and losses.
11.....	220	Real estate tax shelters.
12.....	221	Income averaging.
13.....	223	Multiple incorporation.
14.....		Burden tables.

## EXHIBIT 1

## THE MINIMUM STANDARD DEDUCTION

*Present treatment of deductions*

To compute taxable income, a taxpayer subtracts the value of his exemptions and the amount of his allowable deductions from his adjusted gross income. Subject to the limits imposed by the law, taxpayers may itemize their individual deductible expenses to determine the total amount of their deductions. As an alternative to itemization, the taxpayer may elect the standard deduction. Under present law this deduction is 10 percent of the taxpayer's adjusted gross income or \$1,000, whichever is less. The maximum standard deduction is limited to \$500 on the return of a married person who files a separate return.

*House bill*

The House bill provides a minimum standard deduction equal to \$300 plus \$100 for each exemption after the first. Like the present standard deduction, the minimum standard deduction would be limited to \$1,000. In the case of a married person filing a separate return the minimum standard deduction would be \$200 plus \$100 for each exemption after the first up to a limit of \$500.

Under the bill a single person would be entitled to a minimum deduction of \$300, regardless of his income. A married couple without children would have a minimum deduction of \$400. A married couple with two children would have a minimum deduction of \$600. A married couple, both over 65, would have a minimum standard deduction of \$600. The minimum standard deduction would be of benefit in cases where it exceeds 10 percent of the taxpayer's adjusted gross income.

*Tax relief for persons with low incomes*

The minimum standard deduction would provide tax savings of \$320 million at the 1965 tax rates provided in the House bill. More than 84 percent of savings would go to persons with incomes of less than \$5,000. An estimated 8.3 million persons with incomes of less than \$3,000 would receive tax savings of \$170 million, or more than one-half of the total. The minimum standard deduction constitutes a very important component of the tax bill for persons with incomes of less than \$3,000 who are not in a position to gain very much from a reduction in tax rates.

Nearly 3 million persons with adjusted gross incomes between \$3,000 and \$5,000 would receive tax savings totaling \$100 million, or 31 percent of the relief granted by the provision. The remaining \$50 million of tax relief would go to 2.1 million families with incomes of more than \$5,000 but less than \$10,000.

Under the bill a single person who uses the standard deduction would not have tax to pay unless his income exceeds \$900. At the present time a single person with an income of \$900 who uses the standard deduction incurs an income tax liability of \$44. He becomes liable to tax when his income exceeds \$667.

A married couple would not pay taxes under the bill if their adjusted gross income were less than \$1,000. Presently they pay tax when their income exceeds \$1,333, and they have a tax bill of \$50 on earnings of \$1,600. If the couple had

two children, they would not become taxable under the bill until their income reached \$3,000, a level of income at which they presently pay a tax of \$65.

#### *Efficient way to grant tax relief to low-income families*

The minimum standard deduction would grant tax relief to 13.4 million families with relatively low incomes without greatly reducing the overall tax base. The benefits of the House provision would go primarily to persons with low incomes. Persons with high incomes would find the provision of no benefit.

Equivalent relief to low-income taxpayers granted in the form of an increase in the personal exemption would involve a much greater loss of revenue and would provide the greatest tax savings where they are least needed. It is estimated that an increase in the personal exemption from \$600 to \$700 would cost \$3 billion in tax revenue at current tax rates. At rates in the House bill the cost would be \$2.6 billion.

An increase in the personal exemption would benefit all taxpayers and not just those with low income. Almost three-fourths of the \$3 billion tax savings (at current rates) would go to those with incomes over \$5,000. This accounts for the large revenue cost of an increase in the value of the exemption. All taxpayers would be able to increase their exemptions, and upper income taxpayers would enjoy larger tax savings than persons with lower incomes. Because the tax value of an exemption increases with the taxpayer's marginal rate of tax, an increase in the exemption could help low-income taxpayers only by giving even greater relief to persons with high incomes.

#### *Tax simplification*

The minimum deduction would enable some 1.2 million taxpayers with low incomes to shift from the complex itemizing procedure to the use of the simpler standard deduction. Most of these taxpayers could then file the simple short form tax return instead of the more complicated long form which must be used by all those who itemize.

#### *Tables*

The following tables illustrate features of the minimum standard deduction. Table 1 shows the aggregate tax savings that would result from the minimum deduction when operative for a full year at the lower tax rates provided in the House bill for 1965 and subsequent years. It also shows how many taxpayers would be affected and how the tax savings would be distributed among them. The extent to which low-income families would benefit from the proposal is clear from this table.

Table 2 compares the level at which income becomes taxable for families of varying size under the present law standard deduction with the level at which it would become taxable under the minimum standard deduction.

The examples in table 3 show the combined effect of the minimum standard deduction and the lower 1965 tax rates. The examples demonstrate that the minimum deduction would be of the greatest benefit at the lowest income levels. In some cases taxpayers would become nontaxable. As the level of income rises in the table, percentage tax reductions fall, reflecting the fact that the minimum deduction is less important to taxpayers with higher incomes. Percentage reductions are least where income is high enough so that the minimum deduction is not effective.

TABLE 1.—*Distribution, by adjusted gross income classes, of the full year effect of the minimum standard deduction*

Adjusted gross income class	Tax savings (millions)	Number of taxpayer units <sup>1</sup> (millions)
\$600 and under \$3,000.....	\$170	8.3
\$3,000 and under \$5,000.....	100	3.0
\$5,000 and under \$10,000.....	60	2.1
\$10,000 and over.....	0	0
Total.....	320	13.4

<sup>1</sup> The number of taxable returns which would use the standard deduction and on which the minimum standard deduction would exceed 10 percent of adjusted gross income.

TABLE 2.—A comparison of the levels at which income becomes taxable under present law and under the minimum standard deduction in House bill for taxpayers who use the standard deduction

Taxpayer using standard deduction	Level above which income becomes taxable	
	Under present 10-percent standard deduction <sup>1</sup>	Under minimum standard deduction <sup>1</sup>
Single person.....	\$674	\$900
Married couple (joint return):		
No dependents.....	1,324	1,600
1 dependent.....	1,999	2,300
2 dependents.....	2,674	3,000
3 dependents.....	3,349	3,700
4 dependents.....	3,999	4,400
5 dependents.....	4,649	5,100
6 dependents.....	5,333	5,800

<sup>1</sup> Tax from optional tax table for incomes under \$5,000.

TABLE 3.—Tax savings attributable to House bill rates and the minimum standard deduction for a single person, a married couple with no dependents, and a married couple with 2 dependents, assuming they now use the standard deduction

Adjusted gross income	Tax liability		Tax savings			Tax savings as percent of present tax
	Under present law <sup>1</sup>	Under House bill rates and minimum standard deduction <sup>2</sup>	Total	Due to reduced rates <sup>3</sup>	Due to minimum standard deduction	
<b>Single person:</b>						
\$1,000.....	\$62	\$16	\$46	\$20	\$26	74.2
\$1,500.....	152	87	65	44	21	42.8
\$2,000.....	242	163	79	65	14	32.6
\$2,500.....	332	244	88	81	7	26.5
\$3,000.....	427	333	94	44	0	22.0
<b>Married couple, no dependents:</b>						
\$1,000.....	0	0	0	0	0	0
\$1,500.....	32	0	32	11	21	100.0
\$2,000.....	122	58	64	38	26	52.5
\$2,500.....	212	128	84	64	20	39.6
\$3,000.....	305	204	101	90	11	33.1
\$3,500.....	395	279	116	112	4	29.4
\$4,000.....	485	358	127	44	0	26.2
<b>Married couple, 2 dependents:</b>						
\$2,500.....	0	0	0	0	0	0
\$3,000.....	65	0	65	23	42	100.0
\$3,500.....	155	74	81	60	31	52.3
\$4,000.....	245	144	101	75	26	41.2
\$5,000.....	420	286	134	114	20	31.9
\$6,000.....	600	450	150	44	0	25.0

<sup>1</sup> Tax computed from present tax table for incomes under \$5,000.

<sup>2</sup> Tax computed from tax table in House bill for incomes under \$5,000.

<sup>3</sup> Computed on basis of rate schedule in House bill.

<sup>4</sup> Tax savings attributable entirely to reduced rate.

## EXHIBIT 2

### CURRENT TAX PAYMENT FOR CORPORATIONS

Corporations have been subject previously to two transitions to a more current taxpayment basis; both were completed without adverse economic effects.

The first, generally termed the "Mills plan," was adopted in 1950. Over the period 1950-54, the payments schedule was gradually advanced from four 25 percent quarterly installments during the 12 months following the taxable year

to two 50 percent installments payable in the third and sixth months after the close of the taxable year.

The second transition to partially current payment was adopted as part of the Internal Revenue Code of 1954. This legislation gradually advanced the payment of estimated tax liabilities in excess of \$100,000 over a 5-year transition period beginning in 1955 and completed in 1959. Under this partially current plan, now in effect, a corporation pays 25 percent of its estimated tax in excess of \$100,000 in the third quarter of its current taxable year, another 25 percent in the fourth quarter of the current year; the remainder of the tax due is payable in two equal installments on the filing date of the final return and in the following quarter.<sup>1</sup>

The general tolerance rules of the Internal Revenue Code provide that no penalty for underpayment attaches if the estimated tax payments are based upon (1) 70 percent of the actual tax in excess of \$100,000, (2) last year's tax, (3) the tax at current rates on last year's income, or (4) 70 percent of the tax for the current year (in excess of \$100,000) computed on the basis of an annualization of the year's income to date. Thus, under (1), for example, a corporation with a tax liability of \$500,000 could pay currently as little as \$280,000 without penalty.

The tax bill would advance current payment by gradually shifting the two final 25 percent quarterly payments (of a calendar year corporation) now due on March 15 and June 15 of the following year to two estimated payments on April 15 and June 15 of the current year. The proposal would be effective beginning with 1964 taxable income.

The various payment schedules under the past, present, and proposed payment schedules, including the transitions, are illustrated in table 1.

*Combined effect of proposed current payment plan and rate reduction on corporation internal funds*

Table 2 presents quarterly and annual payments for a large corporation subject to the House bill transition to more current payment. The payments shown are calculated on the assumption that the corporation pays currently close to the minimum allowed by law without incurring penalty. Assuming a constant \$10 million taxable income, the corporation would pay no more in any year of the transition than it would have paid under existing tax rates in the absence of acceleration. Compared to what it was required to pay in 1963, therefore, the corporation would not experience a loss of funds in any year of the transition. This is because the reduction in tax liabilities from rate reduction more than offsets the increase in tax payments due to acceleration.

For a corporation with larger income, annual payments as a percentage of 1963 payments would be no greater than those shown for the \$10 million corporation. Percentages for smaller corporations would be less than those shown in table 2.

*Favorable treatment of smaller corporations*

Tax payments for smaller corporations would begin to decline from the first year of the program and would fall faster than those of large corporations because (1) small corporations receive a larger percentage tax reduction under the House bill and (2) they are required to accelerate payment on a smaller percentage of their (reduced) tax liability. While their entire tax liability is reduced by the lower tax rate, only their liability in excess of \$100,000 (the tax on about \$203,000 of net income under present law) is subject to current payment.

Because of the \$100,000 current payment exemption continued from present law, only about 15,000 corporations, or 2½ percent of the 575,000 taxable corporations in the country, would be subject to the accelerated payment provision. Moreover, the several thousand corporations with tax liabilities slightly in excess of \$100,000 would be little affected. Thus, the great bulk of corporations would enjoy a substantial net increase in funds beginning in 1964 because of rate reductions.

*Strong funds position of corporations*

At the end of the first quarter of 1963 corporations held \$57.6 billion in cash and U.S. Government securities, four times their accrued Federal income tax liabilities (table 5). Their net working capital of \$144.9 billion reached the high-

<sup>1</sup> The taxpayer may, at his option, pay the entire remaining tax at time of filing the final return.



est total on record. Table 4 shows that during 1962 nonfinancial corporations financed a record \$37.5 billion of capital expenditures. In contrast to the high investment years of 1960 and 1957, almost all of the record investment of 1962 could have been financed from their own funds (retained aftertax earnings plus depreciation and other capital consumption allowances). The increase in their liabilities was \$0.9 billion greater than in 1960, but they added \$4.5 billion more to their holdings of financial assets.

#### Effects of the transition

Unlike previous transitions to a more current payment basis (which were accompanied by increasing or constant tax rates) the present proposal would occur simultaneously with tax-rate reductions. These rate reductions will immediately increase aftertax profits both on existing investments and future ventures. The strengthening of investment incentives through tax rate reductions, supplementing the recently enacted investment credit and liberalization of depreciable life guidelines, will far outweigh in significance the faster timing of taxpayments.

The increase in taxpayments resulting from the proposed acceleration would be exactly matched by the reduction in accrued income tax liabilities to the Treasury. As a result, the net working capital of the corporations affected would remain unchanged.

Large corporations typically fund their tax liabilities to the Treasury by the purchase of short-term U.S. Government and other securities. In this way they provide for liquid funds to meet their taxpayments when they are due. To the extent that their taxpayments are accelerated they will incur a loss of interest income from the securities in which they would otherwise invest.

Over the transition period, assuming full funding, corporations would therefore experience a gradual reduction in their interest earnings. After 1970, when they are on a more current payment basis, the annual interest loss is estimated at about \$300 million, at an interest rate of 4 percent. After income taxes, however, the annual reduction of interest income would be about \$150 million. This compares with a tax reduction of \$2.2 billion provided for under the bill.

Corporations have been able to realize such interest income only by virtue of the present system of deferring taxpayments to the Treasury. In effect, they have been receiving the benefits of an interest-free loan. Their future loss in interest income therefore will be matched by an equivalent gain to the Treasury.

TABLE 1.—Illustrative payment schedule for corporation income tax under law prior to 1950, Mills plan 1950-54, partial current payment plan 1955-63, and proposed current payment plan 1964-70<sup>1</sup>

Calendar year	Current taxable year				Following year			
	Apr. 15	June 15	Sept. 15	Dec. 15	Mar. 15	June 15	Sept. 15	Dec. 15
1949								
1950					\$25	\$25	\$25	\$25
1951					30	30	20	20
1952					35	35	15	15
1953					40	40	10	10
1954					45	45	5	5
1955					50	50	0	0
1956			\$5	\$5	45	45		
1957			10	10	40	40		
1958			15	15	35	35		
1959			20	20	30	30		
1959-63			25	25	25	25		
1964	\$1	\$1	25	25	24	24		
1965	4	4	25	25	21	21		
1966	9	9	25	25	16	16		
1967	14	14	25	25	11	11		
1968	19	19	25	25	6	6		
1969	22	22	25	25	3	3		
1970 and subsequent	25	25	25	25				

<sup>1</sup> Calendar year corporation, constant annual tax liability of \$100 subject to current payment, assuming full estimation. For 1965 and later years, figures relate only to portion of estimated tax in excess of \$100,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

**TABLE 2.—Quarterly payments for a \$10,000,000 constant taxable income calendar year corporation (assuming 75 percent estimation) under the program of rate reduction and payments acceleration in the House bill<sup>1</sup>**

[Dollar amounts in thousands]

Year	Calendar year liability	Payments					Calendar year payment	Percent of 1963
		March	April	June	September	December		
1963.....	\$5,195	\$1,612		\$1,642	\$955	\$955	\$5,195	100.0
1964.....	4,993	1,642	\$37	1,679	917	917	5,192	100.0
1965.....	4,794	1,542	141	1,683	880	880	5,120	98.7
1966.....	4,794	1,376	317	1,693	880	880	5,146	99.1
1967.....	4,794	1,200	493	1,693	880	880	5,146	99.1
1968.....	4,794	1,024	669	1,693	880	880	5,146	99.1
1969.....	4,794	848	774	1,622	880	880	5,005	96.3
1970.....	4,794	742	880	1,622	880	880	5,005	96.3
1971.....	4,794	637	880	1,617	880	880	4,794	92.3

<sup>1</sup> (1) Normal tax rate of 22 percent in 1974; surtax rate of 28 percent in 1964; and 26 percent in 1965.  
(2) 1st and 2d quarter current payments in 1964 and 6 succeeding years of 1, 4, 9, 14, 19, 22, and 25 percent.

**TABLE 3.—Treasury receipts from the combined effects of corporate rate reduction and acceleration of taxpayments<sup>1</sup>**

[Revenue gain (+) and loss (-); in millions of dollars]

Fiscal year	Current payment	Rate reduction	Combined revenue effect	Fiscal year	Current payment	Rate reduction	Combined revenue effect
1963.....				1968.....	+1,500	-2,190	-690
1964.....	+260		+260	1969.....	+900	-2,190	-1,290
1965.....	+900	-1,320	-420	1970.....	+900	-2,190	-1,290
1966.....	+1,500	-2,190	-690	1971.....	+40	-2,190	-2,150
1967.....	+1,500	-2,190	-690				

<sup>1</sup> Based on 1963 income level.

**TABLE 4.—Sources and uses of funds: Corporate nonfinancial business**

	Billions of dollars			Percent increase 1962 over—	
	1962	1966	1957	1960	1957
1. Gross saving <sup>1</sup> .....	+436.7	+429.7	+426.3	24	40
2. Capital expenditures <sup>2</sup> .....	+37.5	+33.6	+32.9	12	14
3. Net nonfinancial transactions (1-2).....	-8	-3.9	-6.6		
4. Net increase in liabilities <sup>3</sup> .....	+13.1	+12.2	+12.4	7	6
5. Net increase in financial assets <sup>4</sup> .....	+9.6	+5.1	+4.2	88	129
6. Net financial transactions (4-5).....	+3.5	+7.1	+8.2		
7. Statistical discrepancy (3+6).....	+2.6	+3.3	+1.6		

<sup>1</sup> Capital consumption allowances plus profits minus profits tax payments minus net dividend payments.

<sup>2</sup> Plant and equipment expenditures plus other construction plus inventory change.

<sup>3</sup> Borrowing plus new equity.

<sup>4</sup> Change in monetary assets plus trade lending plus other lending.

Source: U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, August 1963-August 1962, "Flow of Funds/Savings" tables.

TABLE 5.—Current assets and liabilities of corporations

[In billions of dollars]

End of period	Net working capital	Current assets						Current liabilities					
		Total	Cash	U.S. Government securities	Notes and accounts receivable		Inventories	Other	Total	Notes and accounts payable		Accrued Federal income taxes	Other
					U.S. Government <sup>1</sup>	Other				U.S. Government <sup>1</sup>	Other		
1955.....	103.0	224.0	34.6	23.5	2.3	86.6	72.8	4.2	121.0	2.3	73.8	19.3	25.7
1956.....	107.4	237.9	34.8	19.1	2.6	95.1	80.4	5.9	130.5	2.4	81.5	17.6	29.0
1957.....	111.6	244.7	34.9	18.6	2.8	99.4	82.2	6.7	133.1	2.3	84.3	15.4	31.1
1958.....	118.7	255.3	37.4	18.8	2.8	106.9	81.9	7.5	136.6	1.7	88.7	12.9	33.3
1959.....	124.2	277.3	35.3	22.8	2.9	117.7	88.4	9.1	153.1	1.7	99.3	15.0	37.0
1960.....	128.6	289.0	37.2	20.1	3.1	126.1	91.8	10.6	160.4	1.8	105.0	13.5	40.1
1961—4th quarter.....	136.8	306.0	40.3	19.7	3.4	135.5	95.2	12.0	169.3	1.8	111.6	14.0	41.9
1962—1st quarter.....	138.4	308.6	36.9	20.4	3.4	137.0	97.8	13.1	170.2	1.8	111.4	13.5	43.5
2d quarter.....	140.4	313.3	37.2	19.6	3.3	141.0	98.7	13.5	172.9	1.8	113.4	13.6	44.1
3d quarter.....	141.3	320.5	37.5	19.0	3.4	146.4	100.5	13.7	179.2	1.9	117.7	14.6	45.0
4th quarter.....	144.0	325.9	41.0	20.1	3.6	146.5	100.9	13.7	181.9	2.0	119.8	14.9	45.1
1963—1st quarter.....	144.9	327.7	36.9	20.7	3.5	148.7	102.7	15.2	182.8	2.3	120.2	14.1	46.2

<sup>1</sup> Receivables from, and payables to, the U.S. Government exclude amounts offset against each other on corporations' books.

Source: U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, August 1963, p. 1122.

NOTE.—Securities and Exchange Commission estimates: excludes banks, savings and loan associations, and insurance companies.

## EXHIBIT 3

## THE DIVIDEND CREDIT AND EXCLUSION

*Present law*

Under present law, a taxpayer may exclude from his taxable income up to the first \$50 of dividends received from domestic corporations (up to the first \$100 for a husband and wife if each receives dividend income). In addition, a taxpayer is allowed a credit against his tax equal to 4 percent of his dividend income in excess of the exclusion.

*House bill*

The House bill would increase the maximum exclusion from \$50 to \$100 (from \$100 to \$200 for a married couple). The increase in the exclusion would take effect in 1964.

The bill would reduce the 4-percent credit to 2 percent in 1964 and repeal the credit in 1965.

These provisions would increase tax revenues by \$300 million annually when fully effective in 1965.

*Effect on taxpayers*

The combined effect of these two changes alone would be to reduce taxes for 2 million of the 6.2 million taxpayers who receive dividend income. Another 1.7 million taxpayers whose dividends are already excluded would, of course, be unaffected by the change. About 2.5 million taxpayers would find their taxes increased, assuming the two provisions were enacted alone.

However, shareholders, like other taxpayers, would benefit substantially from the overall program of tax reduction—including the reduction in individual and corporate tax rates.

To retain the dividend credit in this bill, considering its other provisions benefiting shareholders, would give them a disproportionate share of the benefits of tax reduction and revision as compared to nonshareholders. The lowering of individual income tax rates would give a double benefit to shareholders—it would reduce their rate of tax both on their ordinary income, such as dividends and salaries, and also on the capital gains included in their income. The bill would also lower the corporate tax rate, making more dividends possible or adding value to shares; and it would double the exclusion of dividend income from taxable income.

Moreover, the 4-percent dividend credit discriminates in favor of shareholders with large dividend income—principally those in the high income brackets—as compared with middle and lower income shareholders with more modest amounts of dividends. This discrimination results because the 4-percent credit provides a larger and larger amount of tax credit as dividend income increases, while the exclusion is the same for all taxpayers.

Repealing the credit would, of course, tend to increase the taxes of those who receive dividend income. Increasing the exclusion, on the other hand, would tend to reduce the taxes of those who receive dividend income. For taxpayers with relatively small amounts of dividend income, the benefits clearly would outweigh the losses. (See table 1.)

Assuming, for example, a 3.2-percent return on stock investment (the average yield on corporate stocks) a single taxpayer in the 20-percent marginal tax bracket would have to have stockholdings of at least \$9,375—and dividends of \$300—before the tax bill changes in the credit and the exclusion would actually increase the tax on his dividends. A married couple in the same bracket filing jointly would have to have stockholdings totaling \$18,750—and dividends of \$600—before the tax on their dividends would be increased from these changes. All those with lesser holdings, of course, would benefit under the House bill.

As another example, take the case of a married man with three children who earns \$15,000 a year. Assuming that he takes the average amount in itemized deductions for his income group, his taxable income would put him in the 20-percent bracket under the present rate schedule. Assuming a 3.2-percent return on his securities, his holdings would have to amount to at least \$23,438—and his dividends to \$750—before his tax increase from the repeal of the credit would equal his tax reduction from doubling the exclusion. At anything less than that amount he would benefit from the change.

Table 1 provides additional examples of single and married taxpayers at different marginal tax rates whose taxes would be unaffected or reduced by eliminating the dividend credit and increasing the exclusion.

Low-income dividend recipients would benefit from the proposed new minimum standard deduction which would—for single people with incomes of less than \$3,000 and married couples with incomes of less than \$4,000—offset any possible adverse effects of changes in the dividend credit.

TABLE 1.—Taxpayers benefiting from an additional dividend exclusion and repeal of the dividend credit

Taxpayers receiving total dividends of this amount or less	Of stocks valued at (3.2 percent rate)—	And subject to marginal tax rate of—	Will pay the same or less tax because the additional exclusion is equal to the 4 percent dividend credit on dividends of—
Single taxpayer (\$50 additional exclusion)			
		<i>Percent</i>	
\$225.....	\$7,031	14	\$175.00
\$237.50.....	7,422	15	187.50
\$250.....	7,812	16	200.00
\$262.50.....	8,203	17	212.50
\$275.....	8,594	18	225.00
\$287.50.....	8,984	19	237.50
\$300.....	9,375	20	250.00
\$312.50.....	9,766	21	262.50
\$325.....	10,156	22	275.00
\$337.50.....	10,547	23	287.50
\$350.....	10,937	24	300.00
Married taxpayers (100 additional exclusion)			
		<i>Percent</i>	
\$150.....	\$14,063	14	\$350.00
\$175.....	14,844	15	375.00
\$200.....	15,624	16	400.00
\$225.....	16,406	17	425.00
\$250.....	17,188	18	450.00
\$275.....	17,968	19	475.00
\$300.....	18,750	20	500.00
\$325.....	19,532	21	525.00
\$350.....	20,312	22	550.00
\$375.....	21,074	23	575.00
\$400.....	21,874	24	600.00

<sup>1</sup> June-July 1963 weekly average, Standard & Poor's Corp. (500 stocks).

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

The reduction in individual tax rates would mean lower taxes for nearly all those who receive dividend income—including those whose taxes on dividends would be raised by the repeal of the credit. The relatively few dividend recipients who might have slightly higher net tax bills as a result of the change in the dividend credit are those whose dividends constitute an extremely large proportion of their total income and who thus own relatively large amounts of invested capital.

Even those few people who might be adversely affected by repeal of the credit and doubling of the exclusion—despite the individual tax cuts, and despite the new minimum standard deduction—would have higher aftertax incomes in the end. This is because the overall tax program—and particularly the planned reduction in corporate tax rates—will mean increase dividend payments. Thus all dividend recipients would benefit from the tax program—because their dividends would be larger.

*The dividend credit is not an effective remedy for the "double taxation" of dividends*

The present dividend credit is based, in large measure, on the concept that stockholders pay tax twice on their dividends; once when the corporation pays income tax on its earnings, and again when they pay individual income tax. This, of course, assumes that the shareholder bears the burden of the corporation income tax. Whether this assumption is actually warranted has been debated at great length. Some, for example, maintain that there is, in fact, no double

taxation of dividends—that the shareholder cannot be regarded as paying the corporate income tax inasmuch as the corporation, with its special privileges and characteristics, is a separate legal entity having a taxpaying capacity quite apart from its stockholders. Others have questioned how much of the corporate income tax is actually borne by the corporation in the first instance and how much is shifted to consumers in higher prices, to employees in lower wages, and to former owners who sold their stock at lower prices to take the tax into account.

Whatever the merit of the double taxation argument, the dividend credit adopted in 1954 does not provide an effective solution. This is discussed below—first describing the effect of the credit on a single dollar of corporate earnings, distributed after payment of present corporate tax to individuals with selected income brackets, assuming the individual rates of the House tax bill, and then examining the effects of the 4-point corporate rate reduction assuming the repeal of the credit.

*Whatever double taxation exists is relatively more burdensome to low-income taxpayers than to high-income taxpayers*

If stockholders are assumed to bear the corporate income tax, the extra burden placed on them consists of the difference between the combined present corporate taxes and House bill individual income taxes paid on corporate earnings and what they would pay in individual income tax if the corporate earnings were distributed to them directly without payment of corporate income tax. Table 2 indicates the size of this extra burden per dollar of corporate earnings distributed, after payment of corporate tax, to a married couple with two dependents at selected income brackets.

TABLE 2.—*Extra burden due to "double taxation" of a single dollar of corporate earnings before tax, assuming reduced individual rates of House bill*

Taxable income brackets (In thousands of dollars)	Marginal tax rates under House bill	Present corporation income tax on \$1 of earnings	Individual income tax on \$0.48 of dividends	Total present tax	Individual income tax if corporate earnings of \$1 were dis- tributed with no corporation income tax	Extra burden due to "double taxation"
	(1)	(2)	(3) \$0.48×(1)	(4) (2)+(3)	(5) \$1×(1)	(6) (4)-(5)
	Percent	Cents	Cents	Cents	Cents	Cents
0 to 1.....	14	52	6.7	58.7	14	44.7
2 to 3.....	16	52	7.7	59.7	16	43.7
4 to 8.....	19	52	9.1	61.1	19	42.1
20 to 24.....	32	52	15.4	67.4	32	35.4
44-52.....	50	52	24.0	76.0	50	26.0
88 to 100.....	60	52	28.8	80.8	60	20.8
140 to 160.....	66	52	31.7	83.7	66	17.7
200 and over.....	70	52	33.6	85.6	70	15.6

NOTE.—Table assumes that the 48 cents of corporate earnings remaining after payment of the present 52 percent corporate income tax are distributed and are eligible for the credit. It also assumes that the stockholder is married and files jointly with his spouse.

The table shows, for example, that the taxpayer in the taxable income bracket \$4,000-\$8,000 would pay on a dollar of corporate earnings a combined tax of 61.1 cents (52 cents corporate tax plus 9.1 cents of individual income tax on the remaining 48 cents distributed to him as a dividend). Since he would pay 19 cents in individual income tax if the entire \$1 of corporate earnings were distributed to him without payment of corporate income tax, the extra burden due to the "double taxation" of dividends is 42.1 cents. It will be noted that extra burden due to "double taxation" is highest—44.7 cents on a dollar—at the first taxable income bracket.

The extra burden on a dollar of corporate earnings declines to 26 cents at the \$44,000-\$52,000 income bracket and to 15.6 cents at the highest taxable income bracket—\$200,000 and over. The reason for the decline in the extra burden per dollar of corporate earnings as the individual's income increases is that at higher income levels the individual is subject to higher marginal individual income tax rates and hence would be able to keep a relatively smaller

part of the funds used to pay corporate income tax had such funds been distributed to him. As a result, any double taxation of dividends which may exist places considerably heavier burdens per dollar of corporate earnings on low-income taxpayers than on high-income taxpayers. This is true even without taking into consideration the substantial tax savings that some high-income taxpayers now secure through the deferral of personal income tax on undistributed corporate profits.

*The 4-percent dividend credit removes much more of the extra burden of "double taxation" for high-income stockholders than for low-income stockholders*

The 4-percent dividend credit has the undesirable effect of removing a very substantial part of the extra burden of "double taxation" for high-income stockholders but only a small part of this extra burden for small and more moderate income stockholders. This is shown in table 3 which, like the preceding table, is based on the attribution to the shareholder of a single dollar of corporate earnings before tax.

The tax reduction received by the shareholder on each \$1 of corporate earnings available for distribution after payment of corporate income tax amounts to 1.9 cents (4 percent of the 48 cents remaining after paying the present 52 cents in corporate income tax). The credit is of no help at all to the nontaxable individual with dividends, who bears a 52-percent tax on his dividends, assuming the validity of the double taxation argument. It removes less than 5 percent of the extra burden resulting from the corporate income tax at the \$4,000 to \$8,000 taxable income level, over 9 percent at the \$88,000 to \$100,000 income level, and more than 12 percent of the extra burden at the highest taxable income bracket of \$400,000 and over.

*Four-point corporate tax reduction will provide equitable relief from "double taxation"*

The 4-point corporate rate reduction in the House bill will not only make investment funds directly available to corporations but it will also provide relief from double taxation of 7.7 percent for all shareholders no matter what their incomes are (table 4). It is noteworthy in table 5 that the dividend credit falls far short of providing the 7.7-percent relief except at the highest tax brackets.

TABLE 3.—*Relief from "double taxation" of dividends provided by the 4-percent dividend credit, assuming reduced individual rates under House bill (for a single dollar of corporate earnings before tax)*

Taxable income brackets (in thousands of dollars)	Extra burden from "double taxation" of dividends	Dividend credit (4 percent of 48 cents)	Extra burden after dividend credit (1) - (2)	Percent of extra burden removed by dividend credit ((2) + (1))
	(1)	(2)	(3)	(4)
	<i>Cents</i>	<i>Cents</i>	<i>Cents</i>	
0 to 1.....	44.7	1.9	42.8	4.3
2 to 3.....	43.7	1.9	41.8	4.4
4 to 8.....	42.1	1.9	40.2	4.5
20 to 24.....	35.4	1.9	33.5	5.4
44 to 52.....	26.0	1.9	24.1	7.3
88 to 100.....	20.8	1.9	18.9	9.1
140 to 160.....	17.7	1.9	15.8	10.7
200 and over.....	15.6	1.9	13.7	12.2

NOTE.—Table assumes that the 48 cents of corporate earnings remaining after payment of the present 52-percent corporate income tax are distributed and are eligible for the credit. It also assumes that the stockholder is married and files jointly with his spouse.

TABLE 4.—Relief from "double taxation" of dividends provided by 4-point rate reduction in corporate income tax, assuming reduced individual rates of House bill (for a single dollar of corporate earnings before tax)

Joint return taxable income brackets (in thousands of dollars)	Marginal tax rates in House bill	Proposed corporate income tax on \$1 of earnings	Individual income tax on 52 cents of dividends (52cents×(1))	Total tax ((2)+(3))	Individual tax if corporate earnings of \$1 were distributed with no corporation tax	Extra burden due to "double taxation" under 48 percent corporate rate ((4)-(5))	Extra burden due to "double taxation" under 52 percent corporate rate	Extra burden removed by 4-point reduction in corporate rate ((7)-(6))	Percent of extra burden removed by 4-point reduction in corporate rate ((8)-(7))
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Percent	Cents	Cents	Cents	Cents	Cents	Cents	Cents	
0 to 1.....	14	48	7.3	55.3	14	41.3	44.7	3.4	7.7
2 to 3.....	16	48	8.3	56.3	16	40.3	43.7	3.4	7.7
4 to 8.....	19	48	9.9	57.9	19	38.9	42.1	3.2	7.7
20 to 24.....	32	48	16.6	64.6	32	32.6	35.4	2.8	7.7
44 to 52.....	50	48	26.0	74.0	50	24.0	26.0	2.0	7.7
88 to 100.....	60	48	31.2	79.2	60	19.2	20.8	1.6	7.7
140 to 160.....	66	48	32.3	82.3	66	16.3	17.7	1.4	7.7
200 and over.....	70	48	36.4	84.4	70	14.4	15.6	1.2	7.7



*Benefits from dividend credit go to high-income taxpayers*

The major part of the tax reductions from the dividend credit accrues to upper-income taxpayers. Low- and moderate-income taxpayers receive only a relatively small part of the total benefit. This is shown by table 6 which indicates the distribution of the aggregate tax reductions resulting from the dividend provisions by adjusted gross income classes for 1960. In that year the total tax reductions from the dividend provisions amounted to \$397 million—\$304 million from the credit and \$93 million from the exclusion.

The distribution of the dividend credit shown in table 6, as is to be expected, is particularly favorable to upper-income taxpayers. About 82 percent of such credits in 1960 were taken on tax returns with more than \$10,000 of income, and 62 percent were taken on returns with more than \$20,000 of income.

This heavy concentration of the benefits of the credit among upper-income taxpayers stems, in large measure, from the fact that such taxpayers receive the bulk of the dividends. Table 7 shows, for example, that in 1960 about 5 percent of the taxable returns with incomes under \$5,000 reported dividends and that for such returns dividends amounted to 1 percent of adjusted gross income. In contrast, 96 percent of the returns with incomes between \$200,000 and \$500,000 reported dividends which amounted to about 40 percent of their income.

TABLE 5.—*Comparison of relief from "double taxation" of dividends provided by the 4-percent dividend credit and by the 4-point reduction in corporate tax rate, assuming reduced individual rates in House bill (for a single dollar of corporate earnings before tax)*

Taxable income brackets	Extra burden due to double taxation	Percent of extra burden removed by—	
		Dividend credit with no corporate rate reduction	4-point reduction in corporate tax
	<i>Cents</i>		
0 to \$1,000.....	44.7	4.3	7.7
\$2,000 to \$3,000.....	43.7	4.4	7.7
\$4,000 to \$8,000.....	42.1	4.5	7.7
\$20,000 to \$24,000.....	35.4	5.4	7.7
\$44,000 to \$52,000.....	28.0	7.3	7.7
\$88,000 to \$100,000.....	20.8	9.1	7.7
\$140,000 to \$160,000.....	17.7	10.7	7.7
\$200,000 and over.....	15.6	12.2	7.7

NOTE.—Table assumes that corporate earnings after corporate tax payment are distributed. It also assumes that the stockholder is married and files jointly with spouse.

TABLE 6.—Distribution of aggregate tax reductions provided by the dividend credit and exclusion, by adjusted gross income classes, for 1960 tax returns.

Adjusted gross income class (in thousands of dollars)	Total number of returns	Number of returns with tax reduction from 1954 dividend provisions	Dividend credit	Tax reduction due to exclusion	Total tax reduction from credit and exclusion
Dollar figures in thousands					
<b>Taxable returns:</b>					
Under \$5.....	22,751,367	1,137,724	\$16,664	\$12,200	\$28,864
\$5 to \$10.....	19,998,074	2,020,378	38,033	25,030	63,113
\$10 to \$20.....	4,421,799	1,526,727	61,778	23,729	90,507
\$20 to \$50.....	764,302	552,547	31,393	19,173	100,566
\$50 to \$100.....	101,030	88,986	46,404	4,660	51,064
\$100 to \$200.....	18,544	17,643	26,193	1,335	27,333
\$200 to \$500.....	4,801	4,619	17,660	331	18,000
\$500 to \$1,000.....	723	703	5,805	54	5,859
\$1,000 and over.....	295	295	7,678	21	7,699
<b>Nontaxable returns.....</b>	<b>12,966,946</b>	<b>806,261</b>	<b>2,618</b>	<b>1,453</b>	<b>4,071</b>
<b>Total.....</b>	<b>61,027,931</b>	<b>6,155,773</b>	<b>304,290</b>	<b>92,786</b>	<b>397,076</b>
Percentage distribution					
<b>Taxable returns:</b>					
Under \$5.....	37.3	18.5	5.5	13.1	7.3
\$5 to \$10.....	32.8	32.8	12.5	27.1	15.9
\$10 to \$20.....	7.2	24.8	20.3	31.1	22.8
\$20 to \$50.....	1.3	9.0	26.8	20.7	25.3
\$50 to \$100.....	.2	1.4	15.2	5.0	12.0
\$100 to \$200.....	(1)	.3	8.6	1.3	6.9
\$200 to \$500.....	(1)	.1	5.8	(1)	4.5
\$500 to \$1,000.....	(1)	(1)	1.9	(1)	1.5
\$1,000 and over.....	(1)	(1)	2.5	(1)	1.9
<b>Nontaxable returns.....</b>	<b>21.2</b>	<b>13.1</b>	<b>.9</b>	<b>1.7</b>	<b>1.0</b>
<b>Total.....</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>1</sup> Less than 0.1 percent.

NOTE.—Table does not include data for 1040A returns which report only a small amount of dividends.

TABLE 7.—Number of individual income tax returns with dividends and amount of dividends in 1960

[Dollar amounts in thousands]

Adjusted gross income (in thousands of dollars)	Number of returns with dividends <sup>1</sup>	Dividends on returns <sup>1</sup>	All returns	Adjusted gross income, all returns	Number of returns with divi- dends as a percent of all returns	Dividends on returns as a percent of adjusted gross income
<b>Taxable returns:</b>						
Under \$5.....	1,199,548	\$715,928	22,751,367	\$69,140,957	5.3	1.0
\$5 to \$10.....	2,097,379	1,291,683	19,998,074	138,455,295	10.5	.9
\$10 to \$20.....	1,554,249	1,813,737	4,421,799	56,128,246	35.1	3.3
\$20 to \$50.....	557,380	2,288,287	764,302	21,901,279	72.9	10.4
\$50 to \$100.....	89,349	1,302,445	101,080	6,617,920	88.4	19.6
\$100 to \$200.....	17,579	757,486	18,544	2,438,326	94.8	31.1
\$200 to \$500.....	4,631	543,527	4,811	1,370,038	96.5	39.7
\$500 to \$1,000.....	704	193,719	723	496,077	97.4	39.9
\$1,000 and over.....	285	274,871	295	584,133	58.6	47.1
<b>Nontaxable returns.....</b>	<b>864,195</b>	<b>701,987</b>	<b>12,966,946</b>	<b>18,314,111</b>	<b>6.7</b>	<b>3.8</b>
<b>Total.....</b>	<b>6,385,299</b>	<b>9,913,670</b>	<b>61,027,931</b>	<b>315,466,382</b>	<b>10.5</b>	<b>3.1</b>

<sup>1</sup> Covers domestic and foreign dividends before dividend exclusions. Does not include data for form 1040A returns which do not specify the amount of dividends received.

As table 8 indicates, returns with incomes under \$5,000 accounted for 59 percent<sup>1</sup> of all returns but only 14 percent of all dividends reported. On the other hand, returns with incomes over \$20,000, or about 2 percent of all returns, received 61 percent of the dividends. About 5,800 returns with incomes over \$200,000—0.01 percent of all returns—accounted for 10 percent of the dividends.

*Factors other than the dividend credit are mainly responsible for the rapid increase in the number of stockholders*

It is questionable whether the dividend credit has encouraged increasing numbers of individuals to become stockholders. According to surveys made by the New York Stock Exchange, the number of shareholders rose from 6.5 million in 1952 to 8.6 million in 1956 and 15 million in 1961. For 1962, the exchange estimates the number of shareholders at 17 million.

TABLE 8.—Number of returns with dividends, total number of returns, and amount of dividends, by adjusted gross income classes for 1960 tax returns

Adjusted gross income class	Total number of returns	Number of returns with dividends	Amount of dividends (millions of dollars)
<b>Taxable returns:</b>			
Under \$5,000.....	22,751,367	1,199,548	\$716
\$5,000 to \$10,000.....	19,998,074	2,097,379	1,292
\$10,000 to \$20,000.....	4,421,799	1,554,249	1,844
\$20,000 to \$50,000.....	704,302	657,380	2,288
\$50,000 to \$100,000.....	101,080	89,349	1,302
\$100,000 to \$200,000.....	18,514	17,579	757
\$200,000 to \$500,000.....	4,801	4,631	544
\$500,000 to \$1,000,000.....	723	704	194
\$1,000,000 and over.....	295	285	275
<b>Nontaxable returns.....</b>	<b>12,986,946</b>	<b>864,195</b>	<b>702</b>
<b>Total.....</b>	<b>61,027,931</b>	<b>6,385,299</b>	<b>9,914</b>
<b>Percentage distribution</b>			
<b>Taxable returns:</b>			
Under \$5,000.....	37.3	18.8	7.2
\$5,000 to \$10,000.....	32.8	32.8	13.0
\$10,000 to \$20,000.....	7.2	24.4	18.6
\$20,000 to \$50,000.....	1.3	8.7	23.1
\$50,000 to \$100,000.....	.2	1.4	13.1
\$100,000 to \$200,000.....	(1)	.3	7.6
\$200,000 to \$500,000.....	(1)	.1	5.5
\$500,000 to \$1,000,000.....	(1)	(1)	2.0
\$1,000,000 and over.....	(1)	(1)	2.8
<b>Nontaxable returns.....</b>	<b>21.2</b>	<b>13.5</b>	<b>7.1</b>
<b>Total.....</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>1</sup> Less than 0.1 percent.

However, factors other than the dividend credit appear to have been primarily responsible for the rapid increase in the number of stockholders in recent years. Between 1954 and 1962 the annual rate of personal saving increased from \$18.9 billion to \$26.2 billion, providing more funds for investment in all types of assets. During the same period, despite some recession years, investment in equities was stimulated by large corporate profits and dividends. Profits rose from \$33.7 billion to \$51.5 billion, while dividends climbed from \$9.8 billion to \$15.9 billion. The Securities and Exchange Commission's Composite Index of Stock Prices (1957-59=100) which was 61.7 in 1954 rose to 116.7 in 1959 and stood at 147.3 at the end of the fourth week of August 1963. The promotion of investment clubs, employee stock-purchase plans and adult education programs for greater understanding of the stock market were also effective in stimulating stockownership.

Despite the increase in the number of stockholders in recent years, it would be a mistake to assume that stockownership is widely prevalent among low-income groups. As would be expected from the heavy concentration of dividends

<sup>a</sup> Including nontaxable returns.

in high-income groups, ownership of stock is similarly concentrated. As table 9 indicates, in 1960 83 percent of all families did not own any stock. Only 9 percent of the families with incomes between \$3,000 and \$5,000 owned stock of some kind, generally in small amounts. In contrast, 66 percent of the families with incomes of \$15,000 and over owned stock, generally in significant amounts.

As shown below, in 1960 families with incomes of \$5,000 or less—47 percent of the total number of families—owned 10 percent of the stock, while families with incomes of \$15,000 or more, or 4 percent of the number of families, owned 42 percent of the stock.

*Concentration of publicly traded common stockholdings, by income classes, 1960*

Income class	Percentage of all families	Percentage of the total value of stock owned
Under \$5,000.....	47	10
\$5,000 to \$10,000.....	39	26
\$10,000 to \$15,000.....	10	22
\$15,000 and over.....	4	42
Total.....	100	100

Source: University of Michigan Survey Research Center, "1960 Survey of Consumer Finances."

TABLE 9.—Family ownership of common stock in relation to family income, 1960

Family income in 1959	Percentage of families owning no stock	Percentage of families owning privately held stock	Percentage of families owning public traded stock	Value of publicly traded stockholdings: percentage distribution				
				Under \$1,000	\$1,000 to \$5,000	\$5,000 to \$25,000	\$25,000 and over	Value not ascertained
Under \$3,000.....	94	1	5	2	2	1	(1)	(1)
\$3,000 to \$5,000.....	92	2	7	3	2	1	(1)	(1)
\$5,000 to \$7,500.....	84	3	13	5	4	2	1	(1)
\$7,500 to \$10,000.....	73	4	23	8	8	6	1	1
\$10,000 to \$15,000.....	56	8	38	14	8	10	3	1
\$15,000 and over.....	34	11	55	7	12	17	19	(1)
All families.....	83	3	14	5	4	3	2	1

<sup>1</sup> No families reported or less than ½ of 1 percent.

NOTE.—Details may not add to totals because of rounding.

Source: University of Michigan Survey Research Center, "1960 Survey of Consumer Finances."

In view of this distribution of stockownership, it is more likely that many of the new stockholders indicated by the New York Stock Exchange's surveys had only small holdings of stock. Quite a few of these newcomers may have been given their stock by a spouse in order to benefit fully from the \$50 exclusion.

*Dividend credit is not effective in stimulating equity investment*

The dividend credit is not an effective means of encouraging equity investment and the development of the Nation's productive capacity. The provision is much inferior to the tax credit for new investment in the Revenue Act of 1962 or the 4-point corporate rate reduction in the House bill. Unlike the investment credit and corporate rate reduction which grant tax relief for actual investment and make funds available for such investment, the dividend credit accords substantial tax reductions to dividend recipients regardless of the use made of the dividends. To the extent that the credit grants an extra incentive for the distribution of dividends which are not reinvested elsewhere, it tends to reduce the amount of corporate funds available for actual investment in plant and equipment.

Although the number of individuals owning stock has increased in recent years, table 10 shows that there has been no upsurge in net purchases of stock by individuals since 1954 when the dividend provisions were adopted.

TABLE 10.—*Net stock purchases by individuals in relation to personal saving, 1951-62*

[Dollar amounts in billions]

Year	Net stock purchases	Personal saving	Net stock purchases as a percent of personal savings	Year	Net stock purchases	Personal saving	Net stock purchases as a percent of personal savings
1951.....	\$1.8	\$17.7	10.2	1957.....	\$1.4	\$23.6	5.9
1952.....	1.7	18.9	9.0	1958.....	1.3	24.7	5.8
1953.....	1.0	19.8	5.1	1959.....	.8	23.6	3.4
1954.....	.8	18.9	4.2	1960.....	-.4	20.9	-----
1955.....	1.2	17.5	6.9	1961.....	.6	25.6	2.8
1956.....	1.6	23.0	7.0	1962.....	-1.6	28.2	-----

Sources: Securities and Exchange Commission, Department of Commerce, and Council of Economic Advisers.

Following the adoption of the credit and exclusion in 1954, net stock purchases by individuals were largest in 1956 when they totaled \$1.6 billion, or 7 percent of personal savings. However, in 1951 when dividends received no relief, net stock purchases amounted to \$1.8 billion, or 10.2 percent of personal savings. These purchases declined below the billion-dollar mark in 1959 and became net sales in 1960. In 1961 net stock purchases amounted to only \$0.6 billion but reverted back to net stock sales of \$1.6 billion in 1962.

In recent years, net stock purchases by individuals have been outpaced by a number of other forms of personal savings. Table 11 shows, for example, that over the past few years time and savings deposits and shares in savings and loan associations and credit unions have absorbed larger amounts of personal savings than net stock purchases and have grown at a faster rate.

It is noteworthy that exempt pension funds, which get no benefit from the 1954 dividend provisions, have become heavy purchasers of stock in the past few years. Between 1954 and 1962 these funds increased the proportion of their total assets held in stocks from 22 to 40 percent.<sup>1</sup> By the end of 1962 they had brought the book value of their stockholdings up to \$14.5 billion, after making net stock purchases during the year amounting to \$2 billion. The latter figure represents about 54 percent of the net receipts of the pension funds for 1962 and is equivalent to 80 percent of the new equity securities issued during 1962. Since the pension funds did not benefit from the 1954 provisions, their increased purchases of stock in recent years appear to be the result of the same more fundamental factors which also encouraged those benefiting from the dividend provisions to invest in stock.

TABLE 11.—*Saving by individuals in stocks, time and savings deposits, and savings shares, 1951-62*

[In billions of dollars]

Year	Preferred and common stocks <sup>1</sup>	Time and savings deposits	Savings shares <sup>2</sup>	Year	Preferred and common stocks <sup>1</sup>	Time and savings deposits	Savings shares <sup>2</sup>
1951.....	1.8	1.9	2.3	1957.....	1.4	6.1	5.2
1952.....	1.7	4.2	3.3	1958.....	1.3	7.7	6.3
1953.....	1.0	4.2	4.0	1959.....	.8	4.1	7.2
1954.....	.8	4.3	4.8	1960.....	-.4	5.0	8.3
1955.....	1.2	3.2	5.2	1961.....	.6	8.8	9.4
1956.....	1.6	3.8	5.4	1962.....	-1.6	15.0	10.1

<sup>1</sup> Includes shares in investment companies.<sup>2</sup> Includes shares in savings and loan associations and shares and deposits in credit unions.

Source: Securities and Exchange Commission, Oct. 1, 1963.

<sup>3</sup> Securities and Exchange Commission, "Corporate Pension Fund, 1963," release No. 1002, May 24, 1963.

*Dividend credit has not increased the share of corporate funds secured from equity financing*

An important objective of the 1954 dividend credit was to encourage equity financing. However, the statistical data strongly suggests that they have failed to achieve this objective. As table 12 indicates, in the period 1954-62 there has been no significant change in the ratio of stock to total corporate external long-term financing. In 1960, for example, this ratio was 31 percent—about the same as in 1954 and considerably below the 40-percent figure reached in 1950 when the dividend credit was not applicable. In 1961, the ratio of total corporate external long-term financing accounted for by stock rose to 40 percent. This, however, was caused not by the dividend credit but rather by rising stock prices and interest rates which created favorable conditions for issue of stock as compared with debt. In 1962, with stock prices falling, stocks accounted for only 21 percent of total corporate external long-term financing. Moreover, as table 13 shows, the proportion of the total capital structure of corporations accounted for by long-term debt has shown a gradual increase between 1954 and 1960, rising from 24.5 percent to 27.3 percent. As indicated in table 14, for 1962, funds secured from internal sources, including retained profits and amounts attributable to depreciation and depletion, were 3.4 times as important as a source of corporate funds than new stock and debt combined.

TABLE 12.—*Net corporate external long-term financing, 1946-62*

[Dollar amounts in billions]

Year	Total net corporate securities	Bonds and other long-term debt			Stocks	Stocks as percent of total securities
		Total	Bonds	Other debt <sup>1</sup>		
1946.....	\$4.2	\$2.9	\$1.1	\$1.8	\$1.3	31.0
1947.....	6.3	4.9	3.0	1.9	1.4	22.2
1948.....	7.2	5.0	4.7	1.3	1.2	16.7
1949.....	4.3	2.7	3.3	-.6	1.6	37.2
1950.....	4.2	2.5	2.0	.5	1.7	40.5
1951.....	7.8	5.1	3.6	1.5	2.7	34.6
1952.....	9.4	6.4	4.9	1.5	3.0	31.9
1953.....	7.6	5.3	4.8	.5	2.3	30.3
1954.....	6.4	4.3	3.8	.5	2.1	32.8
1955.....	8.6	5.9	4.2	1.7	2.7	31.4
1956.....	11.1	7.9	4.7	3.2	3.2	28.8
1957.....	11.9	8.4	7.0	1.4	3.5	29.4
1958.....	10.9	7.3	5.9	1.4	3.6	33.0
1959.....	9.5	5.9	4.1	1.8	3.7	38.9
1960.....	9.8	6.7	5.0	1.7	3.0	30.6
1961.....	11.2	6.7	5.1	1.6	4.5	40.2
1962.....	10.2	8.1	5.0	3.1	2.1	20.6

<sup>1</sup> Bank and mortgage debt.

NOTE.—This series represents the net change in corporate securities outstanding; that is, new issues less retirements of old securities. It excludes securities issued by banks, savings and loan associations, and insurance companies, but includes those of investment companies.

Source: Department of Commerce and Securities and Exchange Commission.

TABLE 13.—Long-term debt of corporations in relation to total capital structure,<sup>1</sup> 1945-60

[Dollar amounts in billions]

Year	Long-term debt	Total capital structure	Ratio of long-term debt to total capital structure (percent)	Year	Long-term debt	Total capital structure	Ratio of long-term debt to total capital structure (percent)
1945.....	\$41.0	\$195.5	21.0	1953.....	\$86.6	\$351.8	24.6
1946.....	45.0	209.6	21.5	1954.....	90.8	370.6	24.5
1947.....	50.1	230.7	21.7	1955.....	98.4	403.8	24.4
1948.....	57.3	254.5	22.5	1956.....	108.9	436.6	24.9
1949.....	61.9	270.1	22.9	1957.....	122.5	466.9	26.2
1950.....	65.7	289.3	22.7	1958.....	132.1	501.2	26.4
1951.....	72.8	311.9	23.3	1959.....	142.9	532.0	26.9
1952.....	80.6	334.6	24.1	1960.....	153.6	562.5	27.3

<sup>1</sup> Total capital structure includes long-term debt, preferred and common stock, surplus reserves, surplus and undivided profits. Long-term debt includes bonds, notes, and mortgages payable having a maturity of 1 year or more.

Source: Internal Revenue Service, "Statistics of Income," Oct. 1, 1963.

TABLE 14.—Corporate financing: External long-term versus internal financing, 1946-62

Year	Stocks, bonds, and other long-term debt	Retained profits, depreciation, and depletion	Total	Stocks, bonds, and other long-term debt	Retained profits, depreciation, and depletion	Total
	Billion dollars			Percent of total		
1946.....	4.2	11.4	15.6	27	73	100
1947.....	6.3	16.6	22.9	28	72	100
1948.....	7.2	18.8	26.0	28	72	100
1949.....	4.3	14.9	19.2	22	78	100
1950.....	4.2	20.8	25.0	17	83	100
1951.....	7.8	19.0	26.8	29	71	100
1952.....	9.4	17.8	27.2	35	65	100
1953.....	7.6	19.7	27.3	28	72	100
1954.....	6.4	19.8	26.2	24	76	100
1955.....	8.6	26.6	35.2	24	76	100
1956.....	11.1	27.8	38.9	29	71	100
1957.....	11.9	28.0	39.9	30	70	100
1958.....	10.9	26.0	36.9	30	70	100
1959.....	9.5	31.1	40.6	23	77	100
1960.....	9.8	29.1	38.9	25	75	100
1961.....	11.2	29.6	40.8	27	73	100
1962.....	10.2	34.9	45.1	23	77	100

NOTE.—Excludes banks and insurance companies, but includes investment companies.

Source: U.S. Department of Commerce and Securities and Exchange Commission.

TABLE 15.—Corporate securities offered for cash 1946-62

(Dollar amounts in millions)

Year	Total corporate securities	Bonds and notes	Stocks			Stocks as a percent of total corporate securities
			Preferred	Common	Total	
1946.....	\$6,900	\$4,882	\$1,127	\$891	\$2,018	29.2
1947.....	6,577	5,036	762	779	1,541	23.4
1948.....	7,078	5,973	492	614	1,106	15.6
1949.....	6,052	4,890	425	736	1,161	19.2
1950.....	6,362	4,920	631	811	1,442	22.7
1951.....	7,741	5,691	838	1,212	2,050	26.5
1952.....	9,534	7,601	564	1,369	1,933	20.3
1953.....	8,898	7,083	489	1,326	1,815	20.4
1954.....	9,516	7,488	816	1,213	2,029	21.3
1955.....	10,240	7,420	635	2,185	2,820	27.5
1956.....	10,939	8,002	636	2,301	2,937	26.8
1957.....	12,894	9,957	411	2,510	2,927	22.7
1958.....	11,558	9,653	571	1,334	1,905	16.5
1959.....	9,743	7,190	531	2,027	2,558	26.2
1960.....	10,154	8,031	409	1,664	2,073	20.4
1961.....	13,147	9,425	449	3,273	3,722	28.3
1962.....	10,770	9,016	436	1,318	1,754	16.3

NOTE.—Includes substantially all new issues of corporate securities with a maturity of more than 1 year offered for cash sale in the United States in amounts over \$100,000. Includes securities issued by banks and insurance companies, but excludes those of investment companies.

Source: Securities and Exchange Commission.

## EXHIBIT 4

## MODIFICATION OF SICK-PAY EXCLUSION

*Present law*

The exclusion for wage continuation payments (commonly known as sick pay) made to an employee while he is absent from work on account of injury or sickness was enacted in 1954. Prior to 1954 wage continuation payments received under an insurance contract financed by an employer were nontaxable to the employee, but similar noninsured benefits paid directly to the employee were included in his income for tax purposes.

Present law permits exclusion, at a rate not to exceed \$100 a week, of employer-financed wage continuation payments, regardless of whether the payment is made under an insured or noninsured plan. That portion of such payments in excess of the limit must be included in gross income, again regardless of the method of payment.

Unless the employee is injured or hospitalized, the exclusion does not become effective until 7 days after the employee leaves work because of his illness. Pensions to disabled workers are considered sick pay eligible for exclusion until such persons reach retirement age.

The exclusion for sick pay has no relationship to the medical expenses incurred. The employee becomes eligible for the exclusion merely by being absent from work because of sickness or injury. Employees who exclude wage continuation payments may also receive tax benefits under other provisions of the Internal Revenue Code which are intended to relieve hardship when an individual incurs substantial medical expenses. For example, many employers provide medical insurance for their employees under which the benefits are tax free. Moreover, those employees who are not covered under medical insurance plans are entitled to the medical expense deduction.

*House bill*

The present provision can apply to a very short absence from work for a minor illness or injury which involves little medical expense. The House bill would modify the present exclusion by giving relief only to those employees who are



likely to incur substantial financial hardship due to illness or injury requiring a long or permanent absence from work. The bill would allow the exclusion of wage continuation payments—up to \$100 a week—after an employee is absent from work for over 30 consecutive days, whether or not the employee is hospitalized and whether or not he is injured.

The House bill would not change the present tax treatment of medical insurance payments, medical expenses, workmen's compensation, Armed Forces disability pensions, or social security disability payments.

#### Revenue and other aspects

The House action would increase revenue by \$110 million annually. In 1960, 1.6 million returns reported the exclusion of \$675.3 million in wage continuation payments. For a large proportion of taxpayers, rate reduction and the minimum standard deduction in the House bill would more than offset the elimination of the exclusion. The average exclusion on taxable returns in 1960 was \$416 and the average salaries and wages after exclusion was \$6,978. Despite the \$100 per week limit, the average sick-pay exclusion was highest for those with the highest adjusted gross income.

#### EXCLUDABLE SICK PAY

TABLE 1.—Revenue gain and distributional effect of modification of sick-pay exclusion

Adjusted gross income class	Revenue gain (millions)	Percentage distribution <sup>1</sup>
0 to \$3,000.....	\$5	4.5
\$3,000 to \$5,000.....	20	18.2
\$5,000 to \$10,000.....	55	50.0
\$10,000 to \$20,000.....	25	22.7
\$20,000 to \$50,000.....	5	4.5
\$50,000 and over.....	( <sup>2</sup> )	( <sup>2</sup> )
Total.....	110	100.0

<sup>1</sup> Sum of percentages may not add up to 100 due to rounding.

<sup>2</sup> Less than \$2,500,000 or 0.05 percent.

Source: Office of the Secretary of the Treasury, Office of Tax Analysts, Oct. 1, 1963.

TABLE 2.—Excludable sick pay, by adjusted gross income classes, all returns, 1960

Adjusted gross income class (thousands of dollars)	Number of returns with salaries and wages (thousands)	Sick-pay exclusion		Total salaries and wages <sup>1</sup> (millions)	Excludable sick pay		Average sick-pay exclusion	Average salaries and wages after exclusion
		Number of returns (thousands)	Percent of returns with salaries and wages		Amount (millions)	Percent of total salaries and wages		
0 to 3.....	17,579	134	0.8	\$374.3	\$90.5	26.6	\$742	\$2,049
3 to 5.....	12,444	363	2.9	1,608.5	154.2	9.6	425	4,011
5 to 10.....	19,108	839	4.4	6,115.9	299.7	4.9	357	6,929
10 to 20.....	3,875	257	6.6	3,119.9	101.6	3.3	395	11,737
20 to 50.....	516	26	5.0	572.6	16.5	2.9	625	21,367
50 and over.....	82	5	6.1	218.9	3.8	1.8	839	46,535
Total.....	53,604	1,624	3.0	12,008.1	675.3	5.6	416	6,978

<sup>1</sup> Includes very small but undeterminable number of nontaxable returns with adjusted gross income over \$20,000.

<sup>2</sup> Returns with excludable sick pay. Total salaries and wages includes excludable sick pay.

## EXHIBIT 5

## DENIAL OF DEDUCTION FOR CERTAIN STATE AND LOCAL TAXES

Under present law, taxpayers who itemize their deductions are allowed to deduct all State, local, and foreign taxes with a few exceptions (principally inheritance and gift taxes, and most taxes for local benefits). Under the House bill, the deduction for taxes would be limited to State and local real and personal property taxes, income taxes, and general sales taxes, and foreign real property taxes, and income taxes. In addition, all taxes paid or incurred in carrying on a trade or business or activities for the production of income would remain deductible.

The principal taxes for which a deduction would no longer be allowed under the House bill are special excise taxes on tobacco, alcoholic beverages, gasoline, motor vehicle license fees and operators' licenses, and miscellaneous special sales taxes (such as taxes on admissions and restaurant meals).

State and local taxes which would continue to be deductible as personal expenses under the House bill account for roughly \$7.5 billion of the \$10 billion of taxes paid deduction reported on 1960 tax returns.

*Revenue gain*

This provision would gain \$520 million of revenue without depriving taxpayers of any major deduction. Under the House bill, this \$520 million is devoted to rate reduction, thus lowering the rates that would otherwise apply. Table 1 shows the breakdown of the \$520 million revenue gain by type of tax. The greatest revenue, \$220 million, would be derived from the denial of the deduction for special excise taxes on gasoline. Table 2 shows the impact of the proposal on the various income groups.

*Simplification of tax return preparation*

The present deduction for miscellaneous State and local excise taxes poses a serious compliance problem for taxpayers. Unlike the property and income taxes, few taxpayers keep records of excise taxes since they are paid very frequently and in small amounts. Extension and laborious recordkeeping is required for those taxpayers who keep track of such taxes. As a result taxpayers who claim the deduction generally resort to rough and arbitrary estimates. Use of such rough estimates creates a serious audit problem for both the taxpayers and the Internal Revenue Service. The Service must check to see that the deductions claimed approximate the amounts of taxes actually paid and consequently taxpayers are frequently called upon to justify and support their estimates. This is a difficult task at best and may often be impossible in the case of an audit 2 or 3 years after the taxes were paid.

In the case of general sales taxes, the Service has developed guidelines which taxpayers can use in place of estimates, but no such guidelines are practicable with respect to special excise taxes because of the wide variety and differences in consumption habits.

The House bill limits deductible taxes to those which are easy for a taxpayer to keep track of (property and income taxes and those for which guidelines are available) general sales taxes, thus reducing considerably the recordkeeping burden of taxpayers claiming the deduction for taxes paid.

*Removal of inequities in present law*

Under present law, the deductibility of State and local special excise taxes depends on the form of the State statute imposing the tax. Generally, taxes are deductible only by the person upon whom imposed. For convenience of administration, many States impose their sales and excise taxes on the retailer, or even the wholesaler, rather than on the consumer. Present law provides that in such cases the tax may be deducted by the consumer only if separately stated and actually paid by him. The distinction under these rules between taxes deductible by the consumer and those not deductible by him is frequently difficult for the average taxpayer to understand since the consumer bears the ultimate economic burden of the tax regardless of on whom imposed by law. Table 3 lists State taxes which are deductible and nondeductible under present law.

Since the deductibility of such taxes depends on the legal form in which the State has chosen to cast its tax, many taxpayers are confused as to whether their taxes are deductible or not. For example, a consumer of cigarettes in one State

can deduct the cigarette tax, but a consumer of cigarettes in another State cannot. Table 3 shows that, of the 47 States and the District of Columbia which impose taxes on the sale of cigarettes, the taxes of 25 States are deductible and those of 22 States are not deductible. In Illinois one type of cigarette tax is deductible and another type is not deductible. As shown by table 3, a similar situation exists in the case of taxes on alcoholic beverages. The taxes of 16 States are deductible and those of 28 States are not deductible. Moreover, special provision is now made in the code to allow the deduction of gasoline taxes in 10 States. As a result some taxpayers do not take full advantage of the available deduction for these taxes, while others, especially those who can afford tax advice do.

By denying a deduction for these special excise taxes, the House bill would end this discrimination between the taxpayers of different States and would alleviate the confusion it has caused. Moreover, such denial of deduction would be consistent with the practice in many States which, for purposes of State income taxes, do not allow a deduction for Federal consumer excises, taxes of other States, or even their own special excises.

#### *Denial of deduction for user charges*

Under present law, taxpayers are not allowed to deduct charges collected by the State for special benefits rendered to the payers; for example, toll charges for highway use, fees for use of parks, hunting or fishing licenses, and so forth. Present law, however, does allow a deduction for certain excise taxes which are, in effect, payments for special benefits provided to users. For example, in 1961, 96 percent of the \$3.5 billion of State motor fuel taxes was allocated for highway construction and maintenance. Like highway toll charges, these taxes are part of the price of consumption, that is personal expenses which should not be deductible. Under the House bill, such user charges would be made nondeductible.

TABLE 1.—Revenue gain from disallowing the deduction of miscellaneous taxes under the tax bill by type of tax

State and local taxes disallowed as a deduction:	Revenue increase (in millions)
Motor fuel.....	\$200
Motor vehicle and operator's license.....	110
Tobacco products.....	75
Alcoholic beverages.....	30
Public utilities.....	20
Other selective sales taxes.....	20
Admissions.....	10
Occupancy.....	10
All other taxes and licenses.....	25
<b>Total.....</b>	<b>520</b>

NOTE.—Under the standard deduction (10 percent of adjusted gross income up to \$1,000) approximately 1,500,000 itemized returns would shift to the standard deduction.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

TABLE 2.—Revenue effect of disallowing the deduction for miscellaneous taxes<sup>1</sup>

Adjusted gross income class	Change from present law <sup>2</sup>		
	Amount (millions)	Percentage distribution	%s percent of present tax
0 to \$3,000.....	+\$10	1.9	+0.7
\$3,000 to \$5,000.....	+50	9.6	+1.2
\$5,000 to \$10,000.....	+220	42.3	+1.2
\$10,000 to \$20,000.....	+130	25.0	+1.0
\$20,000 to \$50,000.....	+60	11.5	+0.9
\$50,000 and over.....	+50	9.6	+1.2
<b>Total.....</b>	<b>+520</b>	<b>100.0</b>	<b>+1.1</b>

<sup>1</sup> All State and local taxes other than property, income, and general sales taxes.

<sup>2</sup> At House bill rates.

TABLE 3.—*Deductibility of State taxes*

## 1. CIGARETTE AND TOBACCO TAXES

## State cigarette tax deductible:

Alabama	New Hampshire
California	New Jersey
Connecticut	New York
Florida	Ohio
Illinois (use tax only)	Oklahoma
Kentucky	Pennsylvania
Maine	Rhode Island
Massachusetts	South Dakota
Minnesota	Tennessee
Mississippi	Texas
Missouri	Vermont
Nebraska	West Virginia
Nevada	Wyoming

## State cigarette tax not deductible:

Alaska	Maryland
Arizona	Michigan
Arkansas	Montana
Delaware	New Mexico
Georgia	North Dakota
Hawaii	South Carolina
Idaho	Utah
Indiana	Virginia
Iowa	Washington
Kansas	Wisconsin
Louisiana	District of Columbia

NOTE.—Colorado, North Carolina, and Oregon do not levy cigarette taxes.

## 2. GASOLINE TAXES

In the following States the gasoline tax although not levied on the consumer is deducted under special code provisions in those cases where the tax is separately stated and passed on to him: Alaska, California, Florida, Hawaii, Kansas, Louisiana, Minnesota, Nebraska, Utah, and Wyoming.

In all other States the tax is levied on the consumer and is deductible.

## 3. ALCOHOLIC BEVERAGE TAXES

In the case of alcoholic beverage taxes the general rule is followed that the tax is deductible only where it is imposed directly on the consumer or separately stated and passed on. The alcoholic beverage tax is imposed on the consumer in the following States: Arkansas, Florida, Massachusetts, Nevada, Ohio, Oklahoma.

In Alabama, Delaware, Maine, Michigan, North Carolina, Pennsylvania, Utah, Vermont, Virginia, and Washington the liquor tax is generally deductible by purchasers at State liquor stores whether or not the tax is separately stated and passed on. In all other States the tax is not deductible. Idaho, Iowa, Mississippi, Montana, New Hampshire, Oregon, and West Virginia do not tax liquor except beer and in some cases wine. The beer and wine taxes of these States are not deductible.

## 4. AUTOMOBILE LICENSE FEES

Automobile license fees and drivers license fees are deductible as taxes in all States, but certificate of title fees, inspection fees, and similar regulatory fees are not deductible.

Not deductible. 5. GIFT, INHERITANCE, OR ESTATE TAXES

Deductible. 6. STATE AND LOCAL INCOME TAXES

7. PROPERTY TAXES

All property taxes, on real and personal property, are deductible by the person against whom they are assessed. Special assessments for improvements, however, are not deductible except in certain selected cases involving a tax levied by a special taxing district.

8. SALES TAXES

All general retail sales taxes are deductible, either because imposed on the consumer or because separately stated and passed on.

9. LICENSE FEES AND POLL TAXES

License fees and poll taxes are deductible, but license fees which are primarily regulatory rather than revenue raising—hunting and fishing licenses, dog licenses, etc.—are not deductible.

10. ADMISSIONS TAXES

In most States the tax on admissions is a part of the general sales tax and is deductible as is the sales tax. Where it is levied as a separate tax, it is deductible where imposed on the purchaser of the admission (South Carolina tax on admission to places of amusement) or where it is separately stated and passed on (Maryland admissions and amusements tax).

TABLE 4.—State and local tax revenue, by source, by level of government, 1961

(In millions of dollars)

Source	State and local governments		
	Total	State	Local
Taxes.....	38,861	19,057	19,804
Property.....	18,002	631	17,370
Individual income.....	2,613	2,355	268
Corporation income.....	1,266	1,265	( <sup>1</sup> )
Sales and gross receipts.....	12,463	11,031	1,432
Customs duties.....			
General sales and gross receipts.....	5,431	4,510	921
Selective sales and gross receipts.....	7,032	6,522	510
Motor fuel.....	3,465	3,431	34
Alcoholic beverages.....	713	688	25
Tobacco products.....	1,077	1,001	76
Public utilities.....	699	401	298
Other.....	1,078	1,000	78
Motor vehicle and operators' licenses.....	1,754	1,641	113
Death and gift.....	501	501	( <sup>2</sup> )
All other.....	2,263	1,632	831

<sup>1</sup> Minor amount included in individual income tax figure.

<sup>2</sup> Minor amount included in "All other taxes."

NOTE.—Table includes taxes that are not deductible as personal deductions under the individual income tax, such as death and gift taxes, fishing and hunting licenses, etc. Moreover, certain taxes are deductible as either personal expense or business expense.

Source: "Governmental Finances in 1961," Bureau of the Census, U.S. Department of Commerce.

TABLE 5.—Amount of taxes deducted and percentage distribution, by adjusted gross income classes, by type of tax on individual income tax returns in 1960

Adjusted gross income classes	Total taxes deducted (millions)	Percentage distribution by type of tax				
		Total	Real estate taxes	State and local sales taxes	State income taxes	Other taxes
Under \$5,000.....	\$1,787	100	40.7	19.7	6.5	33.1
\$5,000, under \$10,000.....	4,779	100	41.4	20.1	10.1	28.4
\$10,000, under \$15,000.....	1,651	100	42.2	18.6	17.4	21.8
\$15,000, under \$20,000.....	599	100	40.0	15.3	27.7	17.0
\$20,000 or more.....	1,710	100	28.8	9.5	48.1	13.6
Total.....	10,526	100	39.3	17.8	17.8	25.1

## NOTES

1. The table does not include taxes which are deductible from gross income arriving at adjusted gross income, that is, taxes reported on individual income tax returns on schedule C (profit from business or profession), schedule F (schedule of farm income and expenses) and schedule B, pt. IV (rent and royalty income).

2. "State and local sales taxes" includes only general sales taxes and not selective sales taxes, such as taxes on cigarettes, liquor, gasoline, etc.

3. "State income taxes" does not include local taxes, such as the income taxes imposed by some cities.

4. "Other taxes" include the following State and local taxes: personal property taxes, gasoline taxes, auto license fees, drivers license fees, poll taxes, cigarette taxes, alcoholic beverage taxes, foreign income taxes, admissions taxes, local income taxes and documentary taxes (as on transfer of securities and mortgage recording). In addition, this category includes real estate, sales, and State income taxes not specifically identified as such by taxpayers on their returns, as well as some taxes which could have been deducted from gross income but which were erroneously claimed as itemized deductions by taxpayers on their returns.

Source: Statistics of Income, Individual income tax returns, 1960.

TABLE 6.—Amount of itemized deductions and the percentage distribution, by adjusted gross income classes, by type of deduction on individual income tax returns for 1960

Adjusted gross income class	Total itemized deductions (millions)	Percentage distribution by type of deduction					
		Total	Interest paid	Contributions	Taxes	Medical expenses	Other deductions
Under \$5,000.....	\$7,024	100	18.0	18.1	25.4	20.0	12.5
\$5,000, under \$10,000.....	16,390	100	27.5	16.9	29.2	14.3	12.1
\$10,000, under \$15,000.....	5,121	100	26.9	18.3	32.2	10.6	12.0
\$15,000, under \$20,000.....	1,734	100	22.8	10.9	34.6	10.2	12.5
\$20,000 or more.....	5,074	100	17.0	28.2	33.7	6.4	14.1
Total.....	35,313	100	23.8	19.1	29.8	14.8	12.5

Source: Statistics of Income, individual income tax returns, 1960.

TABLE 7.—Total number of returns with itemized deductions, by adjusted gross income classes, and the percent of the total within each class with specific deductions, 1960

Adjusted gross income class	Total returns with itemized deductions (thousands)	Percent of total with specific itemized deduction			
		Interest paid	Contributions	Taxes	Medical expenses
Under \$5,000.....	8,387	61.2	92.3	95.9	67.2
\$5,000, under \$10,000.....	11,810	87.2	97.6	99.5	59.7
\$10,000, under \$15,000.....	2,465	83.9	98.9	99.7	47.2
\$15,000, under \$20,000.....	619	80.1	98.7	99.7	40.2
\$20,000 or more.....	802	71.4	98.8	99.4	31.6
Total.....	24,083	77.5	95.9	98.3	59.4

Source: Statistics of income, individual income tax returns, 1960.

#### EXHIBIT 6

#### ABUSES OF INTEREST DEDUCTION WHEN AN INDIVIDUAL USES BORROWED MONEY TO PURCHASE A LIFE INSURANCE POLICY

##### *Nature of abuse*

Minimum deposit and bank loan insurance plans have become a common means for high-income taxpayers to purchase large amounts of insurance for about one-half the cost they would otherwise pay. This is possible because the other one-half of the cost of the insurance is offset by income tax deductions.

Basically, a minimum deposit or bank loan plan involves the systematic borrowing each year of an amount equal to the increase in the cash surrender value under the life insurance policy in order to pay part (and, after a few years, all) of the premium due for that year. Usually the money is borrowed directly from the insurance company, but sometimes it is borrowed from a bank or other person, using the policy as collateral.

The interest on the loan is tax deductible, and the corresponding interest earned under the policy is not currently taxed. If the policyholder dies without having surrendered his policy, his beneficiary also pays no income tax on the interest earned under the policy. In such a case, this interest is, in effect, tax exempt. Moreover, part of the interest earned under the policy is often returned immediately to the policyholder in the form of dividends, which are also tax free. Thus, under the minimum deposit or bank loan arrangement, the taxpayer receives a double tax benefit—a tax deduction for his interest payments and tax-free status for the corresponding interest earned under his insurance policy.

##### *Provision in House bill*

The House bill would deny a policyholder the income tax deduction for his interest payments under a typical minimum deposit or bank loan insurance arrangement. However, the bill contains a number of exceptions to limit the provision to cases in which the borrowing plan is entered into primarily because of the tax advantages. For example, the provision would not apply where the policyholder pays in full four out of the first seven premiums due under the policy. Moreover, it would not apply where the interest payments involved are less than \$100 or where the loan was made because the policyholder encountered unexpected expenses or an unforeseen loss of income. Interested on loans made in connection with the policyholder's trade or business also would not be affected.

*Example of abuse*

The following is an example of the operation of a typical minimum deposit insurance plan. It involves a \$100,000 life insurance policy on the life of a 35-year-old individual in the 50-percent tax bracket:

*Endowment at age 90*

[Age of insured, 35; annual gross premium, \$2,201.50; amount of policy, \$100,000]

Policy year (1)	Annual dividend beginning of year (2)	1 year term insurance cost <sup>1</sup> (3)	Annual loan (4)	Cumulative loan (5)	4.8 percent annual gross interest (6)	Total gross outlay <sup>2</sup> (7)	Net interest cost in 50 percent tax bracket (8)	Annual net outlay (9)	Net estate benefit (10)
1.....	0	0	372	372	18	1,848	0	1,839	99,628
2.....	152	6	1,803	2,175	104	357	52	305	100,025
3.....	182	12	1,832	4,007	192	392	96	296	100,169
4.....	213	19	1,858	5,865	232	432	141	291	100,291
5.....	245	28	1,882	7,747	273	476	186	289	100,009
6.....	298	39	2,105	9,852	317	511	237	75	100,054
7.....	351	50	1,728	11,578	356	556	278	453	100,122
8.....	407	62	1,747	13,325	395	590	320	430	100,005
9.....	462	77	1,768	15,093	434	624	362	411	100,153
10.....	517	93	1,787	16,880	473	657	405	396	100,046
11.....	572	112	1,807	18,687	512	690	449	384	100,017
12.....	632	135	1,822	20,509	552	724	492	355	100,146
13.....	690	160	1,839	22,348	592	757	537	370	100,052
14.....	728	190	1,851	24,199	632	790	581	394	100,121
15.....	755	223	1,862	26,061	672	824	626	434	100,030
16.....	781	262	1,871	27,932	712	857	671	483	100,102
17.....	808	305	1,878	29,810	752	890	716	537	100,080
18.....	836	353	1,884	31,694	792	924	761	596	100,076
19.....	865	410	1,888	33,582	832	957	806	665	100,038
20.....	895	473	1,891	35,473	872	990	852	741	100,002

<sup>1</sup> Cost of additional term insurance purchased each year to maintain actual amount of insurance at a \$100,000 level (column (10)). The amount of additional term insurance purchased each year approximates the amount of the cumulative loan in that year (column (5)).

<sup>2</sup> This figure is equal to the annual gross premium (\$2,201.50) increased by the amounts in columns (3) and (6) and then reduced by the amounts in columns (2) and (4).

NOTE.—This arrangement clearly illustrates how, solely by reason of the tax deduction for interest, the policyholder is able to purchase life insurance for up to 60 percent less than he would otherwise have to pay.

Under this arrangement, the net proceeds (gross proceeds less loan) payable on the death of the policyholder remain at a constant \$100,000 level (col. (10)). This \$100,000 is, in effect, in the nature of term insurance, since the policyholder has, at all times, borrowed the full amount of the cash surrender value. At his age the cost<sup>1</sup> of \$100,000 of term insurance, if bought under a typical term insurance policy, would be \$655 per year for the first 10 years and \$1,220 per year for the next 10 years. However, by using the minimum deposit arrangement, the policyholder is able to purchase term insurance at a cost considerably below that under the ordinary term policy. The following is a comparison of the costs under the term policy and those under the minimum deposit arrangement:

	After 10 years	After 20 years
1. Cost of term insurance.....	\$6,550	\$18,750
2. Net cost under minimum deposit plan after taking into account the interest deduction (col. (9)).....	4,785	9,744
3. Saving under minimum deposit plan (1 minus 2).....	1,765	9,006
4. Tax saving through interest deduction (col. (6) minus col. (8)).....	2,036	8,677

<sup>1</sup> These cost figures represent the annual premiums under a 10-year nonparticipating term policy issued by the Aetna Life Insurance Co.



This chart clearly illustrates that the savings in cost under the minimum deposit insurance plan (Item 3) are made possible mainly because of the interest deduction available to the policyholder (Item 4). In other words, if it were not for the interest deduction, the cost of insurance under the minimum deposit plan would approximate the cost under a typical term insurance policy. However, because of the interest deduction, the policyholder, has, after 20 years, been able to purchase the insurance at a savings of over \$8,500. In other words, he has been able to cut his insurance cost in half.

*Similar abuses have already been prohibited*

Congress has already recognized that the interplay of the interest deduction and the tax-exempt nature of the earnings under an insurance policy give rise to unwarranted tax benefits. Section 264 of the Internal Revenue Code presently denies a deduction for interest on loans incurred to purchase single premium life insurance or annuity policies or policies where substantially all the premiums are paid during the first 4 years. However, the very tax abuse which Congress sought to cure in these cases is still available through the use of annual premium policies which are not covered by section 264. In fact, as is clearly indicated in the advertisement reproduced below and in the attached tax report, insurance companies have developed special annual premium policies to permit the maximum tax benefit. Just as was done in the case of single premium policies the possibility of tax abuses under annual premium policies should be eliminated by denying the interest deduction when such policies are purchased through borrowing.

*Legislation is necessary*

It has been argued that this is not a problem for legislation but rather one for the courts on the ground that the types of transactions involved are merely shams. The very fact that insurance companies have developed special policies to permit the maximum borrowing possible and have advertised the tax benefits flowing from such policies would seem to clearly indicate that the companies themselves do not consider these transactions as merely shams that can easily be struck down by the courts. For example, the following advertisement appeared in the Wall Street Journal for Tuesday, February 26, 1963:

**"TAX SHELTER**

"Corporations and individuals can purchase annuities and life insurance with money that would otherwise have to be paid out in income taxes by purchasing this company's copyrighted contracts with borrowed money. We will lend you the premiums at a low rate of interest—only 4 percent.

"Interest paid on life insurance loans is deductible for income tax purposes under the present Internal Revenue Code. Policy dividends and death benefits paid on the contracts are nontaxable income. Corporations and partnerships are purchasing them for the purpose of buy-and-sell agreements of stock of a deceased stockholder or partner. There is a profit of approximately 50 percent a year on the net interest paid.

"The savings on income taxes can be used to increase dividends, expand a corporation's business, or to provide retirement or pensions plans.

"Just give us your name and mailing address and complete information will be furnished without obligation.

**"SAM HOUSTON LIFE INSURANCE Co.,  
"R. C. SALLEY, President.**

**"HOUSTON, TEX."**

There is also attached a copy of a tax report, written especially for doctors, which not only points out the tax benefits available through the popular minimum-deposit plans but also describes the methods by which insurance companies are varying their policies to produce the maximum tax benefits. This report, as well as the advertisement, is ample evidence that minimum-deposit insurance plans are widely recognized for their tax benefits and represent an area where legislation is clearly needed.

Attachment.

"[From P-H Doctor's Tax Report, Personal and Professional Tax Savings, Prentice-Hall, Inc., Englewood Cliffs, N.J., Mar. 18, 1963]

**"THE DOCTOR'S LIFE INSURANCE: NEW TAX PROPOSALS WOULD STRIP TAX BENEFITS FROM POPULAR MINIMUM-DEPOSIT PLANS**

"Among the many crackdowns requested by the administration as part of a package tax bill, there's one which would deny interest deductions on money borrowed to purchase life insurance. This, of course, is aimed directly at the popular—though controversial—minimum-deposit life insurance plans.

"Whether or not this proposal ever becomes law, it has already accomplished one thing—it's stimulated taxpayer interest in the very tax break it seeks to knock out. For instance, Secretary Dillon's testimony on minimum-deposit plans includes the following phrase:

"\* \* \* high-bracket taxpayers are still able to gain considerable tax advantages by borrowing substantial amounts each year under annual premium policies."

"Many doctors have written in to ask about the tax benefits of such plans. However, before we get into the actual working details, here's a—

"Word of caution: Insurance men and insurance companies are widely split on the advisability of such plans. It is essential, therefore, that you consult your attorney and your insurance representative before taking any action.

"Now, let's see just what makes up a minimum life insurance plan. We'll assume that your practice is booming and your income is climbing. Of course, a higher income calls for more family protection to insure the continuation of your family's station in life, should the unexpected happen. But it's often the case that, when you sit down to work out an adequate insurance plan, you find, despite your rising income, that you don't have the cash to buy sufficient protection. This, according to one school of thought in the insurance world, is where minimum-deposit plans enter the picture.

"How it works: First, you decide the kind and the amount of the permanent insurance protection you need—be it whole-life, 20-payment, or the like. Take out the insurance the way you ordinarily would. Where, then, is the 'plan' and all the benefits and advantages we're talking about? The key to the whole thing is—

"How you pay for the policy: Every year, instead of paying the cash premium less dividends, you borrow the annual increase in the cash value and pay the difference, if any, out of your pocket. So, once you've paid the full premium for the first year, the annual increase in cash value takes over most of the load.

"Important: Some companies issue policies that have an immediate cash surrender value. If you buy one of these, even the first year's cash outlay will be reduced.

"Of course, loans mean interest which, in effect, is added to the premium cost. And, while the interest cost can start getting pretty stiff after a while, here's an angle that really makes the idea appealing to the upper-bracket family protector. It's the—

"Interest deduction: As things stand right now, interest you pay for any bona fide loan is deductible. On the other hand, dividends paid on insurance policies are tax free—they reduce the premium. Under the loan plan, annual dividends go first to the reduction of the part of the premium you pay, and then toward defraying your interest cost.

"Result: You're getting tax-free dividends that help pay your tax-deductible interest.

"Watch this: This interest deduction is what the new tax proposal is gunning for. If the crackdown becomes law, the deduction will be knocked out. Meanwhile, though, it's deductible.

"While the loan is in existence, the net insurance protection is dropping.

"Reason: Since the cash value is your collateral for the loan, that much of the face value belongs to the lender—the bank or insurance company—and only the remainder would go to the beneficiary. But the gradual reduction in protection is slow enough to give the desired primary result—much more insurance protection than you'd ordinarily be able to carry.

"But even this drawback can be mitigated almost painlessly. Those wizards of the actuarial profession have thought up a copy of alternate ways of getting around this decreasing protection handicap:

"(1) *Increasing term insurance.*—Included in the policy, and paid for by the dividends, is separate 1-year renewable term insurance coverage that increases sufficiently in face amount every year to keep pace with the loan.

"Result: The total coverage remains about level.

"(2) *Additional whole-life insurance.*—Under this plan, each year's dividend goes to buy additional single-premium permanent life insurance to cover part of the loan. This is repeated every year, so that, say, after 20 years of coverage, you'd have 21 insurance policies—the main one, and a subsidiary one for each year to cover that year's loan.

"Result: Since the dividends in the early years are relatively low, additional coverage might not completely equal the loan, but this will soon catch up. But, in later years, there is the added advantage of a cash surrender value on every policy. In term insurance, each policy disappears after the year's up."

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## EXHIBIT 7

### THE TAX TREATMENT OF EMPLOYEE STOCK OPTIONS

#### I. HISTORY

##### A. Treatment prior to 1950

Before 1950, the tax treatment of employee stock options was governed by general principles of the Internal Revenue Code and not specifically dealt with except in administrative regulations issued by the Treasury Department. The problem initially was whether the bargain purchase of stock by an employee could result in compensation. T.D. 3435 of 1923, the first attempt of the Treasury to deal with this area, provided that an employee should include in gross income the difference between (a) the fair market value of the property purchased from an employer and (b) the amount paid for it. The Treasury considered that purchases of an employer's stock pursuant to an option were to be treated under this regulation in the same manner as a bargain purchase of other property.

Taxpayers, on the other hand, contended that the exercise of an option could not result in income and, further, that an option intended to provide an employee with a "proprietary interest" in a business was not taxable compensation. The Treasury consistently took the opposite view and prevailed in some cases. However, taxpayers on occasion were sustained by the courts on the point that an intention to provide them with a proprietary interest precluded the realization of income.

In 1939, the Commissioner of Internal Revenue acquiesced in the *Geesman* case (38 B.T.A. 258 (1938)), in which the Tax Court adopted the proprietary interest test. The Treasury regulations were amended to provide that purchases of property by employees at a price "substantially less than fair market value" were taxable only to the extent they were "in the nature of compensation." Profits of "proprietary" grants were taxed as capital gains at the time of sale of the stock. Controversy continued, however, and after a period of uncertainty as to the status of the law regarding stock options, the Supreme Court in 1945 decided the case of *Commissioner v. Smith* (324 U.S. 177). In that case, an employee was given an option to buy the stock of a company whose stock was to be acquired by his employer-corporation upon the occurrence of certain contingencies. The Court held that Smith received compensation upon receipt of this stock.

Following the *Smith* case, the Treasury Department in 1946 amended its regulations to take once again the position that all purchases of stock at less than fair market value by employees were in the nature of compensation. The 1946 Treasury Department regulations led to considerable controversy and agitation for legislation on the subject of stock options.

In 1947 a special tax study committee, formed pursuant to H.R. 293 and 297, recommended special treatment for employee options granted at a price not substantially less than the market price of the stock.<sup>1</sup> The study committee

<sup>1</sup> U.S. House of Representatives, Committee on Ways and Means, revenue revision, 1947-48, hearings, pt. 5, p. 3626 (1947).

recommended that the gain on sale of the option stock be treated as a long-term gain provided it is sold 2 years or more after the option is granted. A minority report criticized such a provision as a species of tax avoidance.<sup>2</sup> "The purpose of every stock option," it stated, "is to enable a few executives to buy stock at a bargain price on a rising market and to sell the stock after 6 months so as to obtain a capital gain."

In the revenue revision bill of 1948, the House of Representatives adopted legislation along the lines recommended by the study committee, against Treasury objections.<sup>3</sup> However, the 1948 provision was dropped by the Senate.

### B. The 1950 legislation

The basic framework of the present legislative provisions regarding restricted stock options was enacted as part of the Revenue Act of 1950.<sup>4</sup> These provisions, as amended in 1954 and 1958, accorded special tax treatment to restricted stock options adopted after February 26, 1945 and exercised after 1949.

At present, under section 421 of the code, if an option qualifies as a restricted stock option, the employee is not deemed to receive taxable income at the time of exercise. In the typical cases where the option price is at least 95 percent of the stock's value at the date of grant, any amount over the option price realized by the employee upon sale of the stock is taxed as a long-term capital gain, provided the sale takes place at least 2 years after the option is granted and 6 months after it is exercised. If the stock acquired with the restricted option is held until death, the gain over the option price is not taxed at all and the employee's estate or heirs receive a stepped-up basis for the stock.

If the option price of the stock is between 85 percent and 95 percent of its market value at the date of grant, when the stock is sold or left at death, part of any amount received over the option price is treated as ordinary income and part as long-term capital gain. Ordinary income tax rates apply to that part of the gain which represents the spread between the option price and the market price of the stock at date of grant, or the spread between the option price and the value of the stock at time of sale or death, if that is lower. The portion of the gain over the option price, in excess of the amount taxed as ordinary income, is accorded the same long-term capital gains treatment described above for 95 percent options.

The corporation receives no deduction at any time for issuing the option.

In order for the option to qualify for the special tax treatment as a restricted stock option, the following conditions must be met:

1. The recipient must be an employee when the option is granted and must exercise it while an employee or within 3 months after his employment is terminated. (However, the 3 months' requirement does not apply when the option is exercised after the death of the recipient.)

2. The option must be nontransferable, except at death.

3. The option must not extend for more than 10 years from the time it is granted. However, if the optionee owns more than 10 percent of the voting stock, the period for exercising the option must not exceed 5 years.

4. The option price must be at least 85 percent of the market price at the time of grant, or 110 percent in the case of an optionee owning more than 10 percent of the voting stock.

The price requirement can be met by a variable price formula based on the market price at time of exercise. Provision is also made for resetting the option price at not less than 85 percent of market value if the market price during the preceding 12 months averages less than 80 percent of the price at time of grant.

### C. Provisions of the House bill

Section 214 of the bill, as passed by the House of Representatives, revises the tax treatment of restricted stock options in order to prevent certain abuses in their use.

*Executive stock options.*—The present law is continued for stock options (referred to as restricted stock options) granted before June 12, 1963. The House bill adds a new section, section 422, to the code which will govern options granted after June 11, 1963 (referred to as qualified stock options). It imposes certain restrictions and limitations on such options to prevent specific abuses which were

<sup>2</sup> *Ibid.*, p. 3653.

<sup>3</sup> 80th Cong., 2d sess., H.R. 6712 (May 26, 1948), sec. 137; Congressional Record, vol. 94, No. 106, p. 8090.

<sup>4</sup> U.S. Senate, the Revenue Act of 1950, 81st Cong., 2d sess., Rept. 2375, sec. 220.

called to the attention of the Ways and Means Committee by the Treasury Department and various witnesses. The full tax benefits accorded qualified stock options will be available only if the following requirements are satisfied:

(1) The stock must be held for 3 years after the option is exercised. Present law requires that the stock not be sold for 2 years after grant of the option and that the stock be held for 6 months after exercise. The new rule will better insure that such options are being used by corporations to give executives and other employees a proprietary interest in the business and to restrict their use as compensation taxable at capital gains rates.

(2) The option must be exercisable within a period of not more than 5 years. Present law allows such options to extend for a 10-year period. The new provision restricts the period during which an executive can receive the benefits of rising market values for the option stock without the investment of any of his own funds.

(3) The option must be issued at a price equal to the fair market value of the stock at the time the option is granted. Under present law the option price may be 85 percent of the fair market value on the date of grant. In order to protect against unintentional underpricing of closely held stocks, however, the new section specifically provides that the option will not be disqualified if a good-faith effort was made to determine the fair market value of the corporate stock. However, to insure that taxpayers do not take undue advantage of this provision, the new section provides that 150 percent of the amount by which the option is underpriced (with certain limitations) is to be reported as ordinary income in the year the option is exercised.

(4) No qualified stock option may be granted to an individual owning more than 5 percent of the corporate stock in the case of a corporation with equity capital of \$2 million or more. The percentage of stock ownership permitted is gradually increased in the case of smaller corporations to a maximum 10 percent of the stock of a corporation with equity capital of \$1 million or less. Restricted stock options may be granted to substantial stockholders without limitation under present law if the option price is 110 percent of the market price of the stock at grant and the option is for 5 years or less.

(5) The option must be granted pursuant to a plan which has been approved by the shareholders within 10 years. This is to insure that the owners of the corporation approve of the issuance of the options. Present law contains no such provision.

(6) The option price may not be reduced because of a drop in the price of the corporation's stock. Present law allows such "resetting" under limited circumstances. The fundamental purpose of stock options is to encourage business executives to improve the efficiency and profitability of their employer-corporations. It is contrary to this purpose to allow a corporation to reduce the option price if the value of the stock falls. In order to prevent avoidance of this rule by simply issuing additional options at a lower price, the House bill requires that options be exercised in the order of their grant. Thus, the employee may not exercise a stock option until an earlier option has been exercised or has lapsed.

*Employee stock purchase plans.*—Certain corporations allow virtually all of their employees to purchase stock in the corporation at a discount from the market price. These plans, commonly referred to as stock purchase plans, differ substantially from executive stock options since they are issued on a nondiscriminatory basis and are used, at least in part, as a device for raising needed capital. They have, however, been taxed in the past under the provisions dealing with restricted stock options.

The House bill contains a new section 423 of the code which will continue the present tax treatment for these employee stock purchase plans. Thus, options under these plans may be issued in the future at 85 percent of the fair market value of the stock as under present law, rather than at 100 percent of the market price as will be required in the future for executive stock options. New section 423 contains various rules designed to insure that these plans will be non-discriminatory in their operation.

## II. APPRAISAL OF CERTAIN PROVISIONS

The experience with restricted stock options indicates that there are strong grounds for modifying certain aspects of the tax treatment of such options to assure that they are not being used simply to compensate corporate executives at capital gain rates. The changes in present law made by the House bill are intended to have this result.

### A. Price reset provisions

Under present law, it is possible for an executive to derive substantial gains from an option even if the price of the company's stock declines greatly after the date the option is granted. Section 421(e) of the code provides that when the average fair market value of the stock under option for the 12 preceding months is less than 80 percent of its value on the date of the original grant, a lower price may be substituted for the original option price. In such a case, the option price may be "reset" at a price as low as 85 percent of the current value of the stock.

Many corporations have taken advantage of the provision allowing option prices to be reset. To illustrate this practice, details concerning such price resetting in seven actual cases are presented below:

Company	Number of shares	Original option prices	Reset prices
A.....	12,800	\$13.82	\$31.83
B.....	193,000	117.25	68.50
C.....	21,022	\$53.00-51.90	49.30
D.....	256,486	69.35-77.07	52.49
E.....	11,500	14.25	8.62
F.....	177,965	45.90-58.75	\$33.37-37.17
G.....	94,000	24.87	10.38

Resetting of the option price is inconsistent with the purpose of the stock option provision of allowing a corporation to offer its executives incentives to improve the profitability of the corporation and thereby increase the value of the company's stock. The provision makes it possible for an executive to secure substantial benefits from an option even if the market price of the stock falls below the initial option price. The House bill prohibits the reduction of the option price because of a fall in the market price of a company's stock. To prevent circumvention of this rule by merely issuing a new option at a lower price, the House bill requires that no option be exercisable until an earlier option has been exercised or has lapsed.

### B. Selling option stock

Contrary to the intention of the Congress in providing for the preferential tax treatment of restricted stock options, corporate executives have, in many cases, sold their option stock rather than holding it for investment. Some measure of this trading is indicated by the stock option experience of a sample of 215 top executives, covering the period 1950-60 (table 1). Of those who exercised options, only slightly less than 40 percent still held all their stock at the end of the period, and only half retained at least 80 percent. But 48 executives (over 25 percent) sold more than half their option stock, and 11 (6 percent) sold it all.

TABLE 1.—Disposition of option stock by 215 top executives, 1950-60

	Number	Percent		Number	Percent
Number of executives.....	215	-----	Percent of option stock sold— Continued		
Number not exercising options.....	27	-----		40 to 50.....	16
Number exercising options.....	188	100.0	50 to 60.....	12	6.4
Percent of option stock sold:			60 to 70.....	5	2.7
None.....	73	38.8	70 to 80.....	12	6.4
0 to 10.....	7	3.7	80 to 90.....	6	3.2
10 to 20.....	16	8.5	90 to 100.....	2	1.1
20 to 30.....	19	10.1	100.....	11	5.9
30 to 40.....	9	4.8			

Sources: A study of stock option benefits provided by 350 large corporations, conducted by Profs. George E. Lent and John A. Menge, Dartmouth College, under a grant by the Alfred P. Sloan Foundation to the Amos Tuck School: "The Importance of Restricted Stock Options in Executive Compensation," Management Record, June 1962, pp. 6-13.

Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

Another indication of the turnover of option stock is provided by a Treasury study of transactions in option stock by 528 executives in 86 companies over the 3-year period January 1958 through December 1960. The study (which was based on the Securities Exchange Commission monthly "Official Summary of Security Transactions and Holding") disclosed that for the period under review the 528 executives purchased over 1.7 million option shares.<sup>1</sup> Two-thirds of the 528 executives disposed of at least some option stock during the period. These dispositions amounted to about 490,000 option shares—almost half the number of option shares acquired by the group with sales and over 27 percent of the total number of option shares acquired by all 528 executives.

The results of the Treasury study are confirmed by the McKinsey survey, which reported an average retention of 75 percent of option stock by executives in a sample of 72 large companies.<sup>2</sup>

The Treasury study shows further that of the executives making dispositions, 24 percent sold all the option stock received during this period, and 60 percent sold half or more. The frequency distribution of dispositions as a percentage of acquisitions is presented below:

Dispositions as a percent of acquisitions	Number	Percent of total	Dispositions as a percent of acquisitions	Number	Percent of total
0.1 to 9	12	5.2	70 to 79	9	3.9
10 to 19	23	10.0	80 to 89	11	4.8
20 to 29	16	7.0	90 to 99	12	5.2
30 to 39	21	9.6	100	54	23.6
40 to 49	18	7.9			
50 to 59	30	13.1	Total	229	100.0
60 to 69	22	9.6			

Regardless of the reason for the sale of the optioned stock, sale of the stock by the executive is inconsistent with the purpose of the stock option provision of allowing corporations to give executives a proprietary interest in the employer-corporation. The House bill requires that the optioned stock be held for a period of 3 years if the executive is to obtain the full benefits accorded qualified stock options. This provision will assure that the executive will have a proprietary interest for at least 3 years and that the option will not be exercised with a view to selling the stock at the end of 6 months, as is possible under present law.

#### *C. Large option gains accrue to shareholders controlling closely held corporations*

In approving the original legislation in 1950, the Congress denied the tax benefits of restricted stock options to recipients owning, directly or indirectly, more than 10 percent of the voting power of the employer-corporation at the time the option is granted. According to the Senate report on the bill: "This rule is intended to prevent the use of stock options by employers who seek to convert the earnings of a corporation from ordinary income into a capital gain."<sup>3</sup> With the enactment of the Revenue Act of 1954, however, Congress amended the law to permit owners of 10 percent or more of voting stock to obtain the tax benefit of restricted stock options, provided they were issued at not less than 110 percent of the market price at time of grant and were exercised within 5 years.

Present-day practice in the use of options by those in control is inconsistent with the reasons announced for this change. According to the Senate report, the attention of the committees was called to cases of stockholder-employees of closely held corporations "who use stock options to retain control of their company when procuring outside equity financing."<sup>4</sup> Where the option price was

<sup>1</sup> In order to put acquisitions and sales on a comparable basis, the study did not record acquisitions during the last 6 months of the period under review. This is because it is not likely that option stock acquired in these 6 months was sold in the same 6 months. Such a procedure would result in the loss of long-term capital gains treatment on the option benefits and also in the possible application of sec. 16(b) of the Securities and Exchange Act involving repayment of the gain to the employer corporation.

<sup>2</sup> McKinsey & Co., Inc., "Stock Option Administration in the Leading Companies (December 1961), pp. 2-14.

<sup>3</sup> Rept. 2375, op. cit., p. 60.

<sup>4</sup> U.S. Senate, Committee on Finance, report to accompany H.R. 8300, 83d Cong., 2d sess., Rept. 1022, p. 60.

substantially above the market and the option exercisable only for a limited time, according to the committee, "it would appear that the options in these cases are not intended as compensation."

A 5-year option to buy stock at 110 percent of the market price at the date of grant ordinarily has considerable value. Calls, giving the purchaser the right to buy stock at a stated price over a brief period of time, generally sell for significant amounts even when the call price is over the market price at the time the call is sold. Recently, for example, a firm advertised a call giving the right to buy at 67½ United States Steel which had closed on the previous day at 58¾.<sup>8</sup> The price of the call, which was for a 5-month period, was \$137 per 100 shares of stock. Obviously, if the call were extended to 5 years to correspond with the period over which stock options granted to stockholder-employees can be exercised, it would sell for a much higher price.

Most executives owning a substantial voting interest waive their option rights. Nevertheless, the practice of others in granting themselves options is sufficiently widespread to call attention to the undesirable results of this practice. Some of the more significant cases, secured from proxy statements, are summarized below:

The president of a large manufacturing company received options at 110 percent of market value to purchase 8,000 shares in December 1956, when he and his wife and children owned 12.2 percent of the voting stock. Between October 1959 and September 1961 he exercised all these options. Because of the unusual rise in the value of the stock over this period, involving numerous stock splits, he realized option benefits amounting to an estimated \$3,930,000. Over the 5-year period his salary is estimated to be less than \$1 million.

In July 1957 the board of directors of a large drug company granted the president options to purchase 57,500 shares of stock out of the 125,000 shares reserved for the purpose.<sup>9</sup> The president, who with his family owned 51 percent of the stock, was the only officer to receive options, the balance of 67,500 shares being set aside for future grants. At the time of exercise the option shares had a value of \$2,450,000. These benefits amounted to 5½ times his 5-year salary of about \$440,000.

A large metals company, in which one family owned a 54-percent interest, granted options to two members, the total exercised benefits of which aggregated about \$2,200,000.

The chairman of a large chemical company, who owned a direct and beneficial interest of 10.5 percent, received substantial stock options. The total value of benefits on exercise amounted to about \$1,265,000.

The president of an aircraft company, who directly and indirectly owned about 10 percent of the voting stock, exercised options with a total benefit of about \$500,000.

As a result of stock options and other purchases, the president of a metal fabricating company increased his ownership to about 15 percent of the voting shares. His exercise of options netted about \$620,000.

An executive who owns a substantial portion of the stock of a corporation already has an incentive to improve the company's efficiency and profitability. Beyond certain limits there is no justification for granting qualified stock-option benefits to such a person. Accordingly, the House bill denies qualified stock option treatment to options issued to the holder of more than 5 percent of the stock of a corporation having equity capital of \$2 million or more. Qualified stock options may be issued to the owner of a larger proportion of shares of a corporation with equity capital of less than \$2 million. The maximum ownership of stock of the employer corporation by any person receiving a qualified stock option will be 10 percent in the case of a corporation having \$1 million of equity capital or less.

<sup>8</sup> New York Times, May 18, 1962.

<sup>9</sup> The seven-man board consisted of three members of the president's family, the administrative vice president, and representatives of the company's law firm and investment bankers.



## EXHIBIT 8

## PERSONAL HOLDING COMPANIES

Since 1934, the revenue laws have recognized the necessity of imposing special taxes on the undistributed income of a personal holding company which is used as a shelter by high-bracket taxpayers. Under this device, a taxpayer places investment assets producing "passive" income in a corporation so that such income would be taxed at the lower corporate rate, which, in the case of dividend income, is only 7.8 percent under present law. Accordingly, a company which is used as a tax shelter in this manner by five or fewer persons owning more than 50 percent of the stock of the company is subject to a special additional corporate tax—the personal holding company tax. The purpose of this tax is not to collect revenue under its imposition, but to encourage the personal holding company to distribute its earnings to its shareholders. Earnings which are so distributed are not subject to the personal holding company tax.

However, under present law, there is evidence that the personal holding company provisions have not been tight enough to prevent the use of corporations as a shelter for passive income. Various methods have been used by corporations to avoid personal holding company status. Some of the most important of these are: By producing more than 20 percent of gross income from an "active" operating business, even though the operating business produces only a relatively small amount of net income, or even none; by producing 50 percent of gross income from rents; producing gross income from a working interest in an oil well of more than 20 percent of total gross income, even though the net income from such oil well may be relatively small or even none; and by producing 20 percent of gross income from capital gains from the sale of assets other than stocks or securities, or from commodity transactions.

H.R. 8363 adopts certain provisions with respect to personal holding companies which are designed to prevent the use of these devices which are presently used by corporations to avoid personal holding company status. The following examples illustrate these devices and the application of H.R. 8363 with respect to them:

## GROSS INCOME TEST

*Example 1*

Corporations T's income and deductions are as follows:

## Gross income:

From contract for stockholder L's services.....	\$300,000
Telephone answering service.....	100,000
Total.....	<u>400,000</u>

## Expenses:

Attributable to contract.....	50,000
Attributable to telephone answering service.....	95,000
Total.....	<u>145,000</u>

Taxable income.....	255,000
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All of the shares of corporation T are owned by L, a television star, and W, his wife. The corporation receives \$300,000 for the services of L who is under contract to T corporation and is paid a salary of \$100,000 annually. T corporation has purchased a telephone answering service for \$75,000. Thus, the net income attributable to the telephone answering service is only \$5,000 (\$100,000 minus \$95,000). Nevertheless, the \$100,000 of gross income from the telephone answering service shelters the \$200,000 of net income which the corporation receives for L's services (\$300,000 gross income minus \$100,000 salary paid to L) from the personal holding company provisions. (Under existing law, the income which the corporation receives for its shareholder's services is personal holding company income, since it really represents the shareholder's earnings which he attempts to have taxed at corporate rates instead of individual rates. The example, of course, would equally apply if the \$200,000 of income from L's services was dividend income instead). Thus, under existing law, without the telephone answering service, all of the income that corporation T receives for the services of its stockholder L would constitute personal holding company income. However, under existing law, since the gross income from the telephone

answering service (\$100,000) constitutes more than 20 percent of gross income (\$400,000), the corporation is not a personal holding company.

Under H.R. 8363, the operating income must constitute more than 40 percent of the gross income, and thus the corporation is a personal holding company.

## RENTAL INCOME

*Example 2*

Corporation U, which is wholly owned by a high-bracket taxpayer, has the following items of income and deductions:

## Gross income:

Dividends.....	\$135,000
Rents (from factory and warehouse).....	145,000
<b>Total.....</b>	<b>280,000</b>

## Deductions:

Real estate taxes.....	20,000
Interest.....	25,000
Depreciation.....	35,000
Other expenses.....	5,000
Dividends received deduction.....	114,750

<b>Total.....</b>	<b>199,750</b>
<b>Taxable income.....</b>	<b>80,250</b>

Corporation U's assets are as follows:

Stocks.....	3,500,000
Factory and warehouse.....	700,000
Mortgage.....	400,000
<b>Equity.....</b>	<b>300,000</b>
<b>Total.....</b>	<b>3,800,000</b>

The rental income is received with respect to a "net lease" under which corporation U's only expenses are real estate taxes and certain insurance premiums.

Since the rental income of \$145,000 is in excess of 50 percent of the total gross income, \$280,000, the rental income does not constitute personal holding company income and corporation U is not a personal holding company. Accordingly, an equity of investment of only \$300,000 is able to shelter dividend income produced by \$3.5 million of stocks.

Under H.R. 8363, the gross rental income must be reduced by real estate taxes (\$20,000), interest (\$25,000) and depreciation (\$35,000). Hence, the rental income which must exceed 50 percent of gross income is \$65,000 (\$145,000 minus \$80,000). Accordingly, since \$65,000 rental income does not constitute 50 percent of the total income (\$200,000), the corporation is a personal holding company.

*Example 3*

Corporation R, a closely held corporation, has the following items of income and deductions:

## Gross income:

Dividends.....	\$250,000
Rents (from office building).....	750,000
<b>Total.....</b>	<b>1,000,000</b>

## Deductions:

Real estate taxes.....	120,000
Interest.....	40,000
Depreciation.....	140,000
Management fee.....	75,000
Other rental expenses.....	175,000
Dividends received deduction.....	212,500

<b>Total.....</b>	<b>762,500</b>
<b>Taxable income.....</b>	<b>237,500</b>

Under existing law, since the rental income of \$750,000 constitutes more than 50 percent of the total gross income of \$1 million (\$750,000 plus \$250,000), the rents are not personal holding company income and the corporation is not a personal holding company.

Under H.R. 8363, the rental income must be reduced by taxes (\$120,000), interest (\$40,000), and depreciation (\$140,000). Accordingly, rental income will be \$450,000 (\$750,000 minus \$300,000). The corporation meets the 50-percent requirement since the rental income (\$450,000) is more than 50 percent of total income, \$700,000 (\$450,000 plus \$250,000). However, an additional test is provided in order for rental income not to be classed as "personal holding company income," under which personal holding company income of the corporation (other than rental income), \$250,000, must not constitute more than 10 percent of the total income, \$1 million. Accordingly, corporation R's rents constitute personal holding company income and all of corporation R's income is personal holding company income. Thus, under H.R. 8363 the corporation is a personal holding company.

*Example 4*

Corporation J's income and deductions are as follows:

Gross income:	
Dividends.....	\$600,000
Oil (working interest).....	500,000
Total.....	<u>1,100,000</u>
Deductions:	
Depletion.....	400,000
Interest.....	64,000
Other expenses.....	30,000
Dividends received.....	490,000
Total.....	<u>984,000</u>
Taxable income.....	116,000

Corporation J's assets consist of \$15 million in stocks and a working interest worth \$2 million in an oil well, payment for which was made by the corporation with \$100,000 of its own funds and a loan of \$1,800,000 at 4-percent interest from the seller secured by a pledge of corporation J's stock portfolio.

Under present law, the equity investment of \$400,000 in the oil well provides a shelter for the passive income from \$15 million of stocks. This is because the gross income from the oil well, \$500,000, constitutes more than 20 percent of the total gross income of the corporation, \$1,100,000 (the sum of \$600,000 dividend income and \$500,000 oil income).

Under H.R. 8363, for purposes of the personal holding company income computations, the income from the working interest in the oil well, \$500,000, is reduced by depletion (\$400,000), and interest (\$64,000), allocable to the working interest, so that the total income from the oil well is only \$36,000 (\$500,000 minus \$464,000). Accordingly, the corporation is a personal holding company since the personal holding company income (\$600,000 of dividends) is more than 60 percent of the total income (\$634,000).

CAPITAL GAINS ON ASSETS OTHER THAN STOCKS, SECURITIES, OR COMMODITIES

*Example 5*

M corporation sells all of its assets for \$50,000. It receives \$700,000 in cash which it invests in securities producing dividends of \$28,000 annually. The other \$150,000 is to be received in five equal installments over a 5-year period. The payments are to be paid with respect to assets which the corporation had used in its trade or business. The corporation had a basis in such assets of \$40,000. M corporation reports the gain on the installment method, and accordingly rec-

ognizes \$22,000 of capital gain in each of the 5 years (one-fifth of \$150,000 minus \$40,000). Accordingly, corporation M's income and deductions are as follows:

Gross income:	
Dividends.....	\$28,000
Capital gains (from installment sale of capital assets other than stocks, securities, or commodities).....	22,000
Total.....	50,000
Deductions: Dividend-received deduction.....	23,800
Taxable income.....	26,200
Ordinary income.....	4,000
Capital gains.....	22,000

Under existing law, M corporation is not a personal holding company. The total gross income annually is \$50,000 (\$28,000 of dividends and interest, and \$22,000 of capital gains). Since the personal holding company income (\$28,000) is less than 80 percent of total gross income (\$50,000), the corporation is not a personal holding company.

Under H.R. 8363, such capital gains are excluded for purposes of determining the corporation's percentage of personal holding company income. Hence, for this purpose, gross income is \$28,000 and, accordingly, all of the company's gross income is personal holding company income.

#### EXHIBIT 9

##### GROUPING OF OIL AND GAS PROPERTIES

Present law provides that percentage depletion cannot exceed 50 percent of the net income from the property. This provision has been in the tax law since 1924, and preceded the adoption of percentage depletion for oil and gas properties in 1926.

This exhibit deals with the provision in present law which permits oil and gas producers to combine or aggregate properties in applying this 50-percent net income limitation. Under present law, any number of oil leases may be combined for percentage depletion purposes if they are in one operating unit. This presents an opportunity to combine high-income with low-income properties in order to avoid the application of the net income limitation to the low-income properties. The larger the operating unit used by the taxpayer, the greater is the tax advantage that can be gained from this provision. Table 1 contains actual examples of operating units being used by oil companies as a basis for combining large numbers of oil leases so as to avoid the application of the net income limitation. As this table indicates, some oil companies seek to use large operating units so that they can combine leases over widespread areas.

Once having determined an operating unit, the taxpayer is permitted to combine any number of leases within the unit and leave separate any number of leases. The current practice is to combine sufficient high-income and low-income properties so as to avoid the 50-percent limitation in the case of the low-income properties. Those leases in the operating unit which are subject to cost depletion and those high-income leases which are not needed to balance the low-income leases are treated as separate properties. Under this system, leases are combined without regard to contiguity or actual production practices solely to maximize the percentage depletion allowance. For example, operating unit No. 1, set forth in table 1, covers 138 oilfields and contains 767 leases. Of these, the company involved chose to aggregate 305 and treat 462 as separate properties.

The effect on percentage depletion and the tax effect of the operating unit concept can be illustrated by the following examples, obtained from income tax returns of several large oil companies.

In 1952, 1953, and 1954, company X, computing percentage depletion on a lease-by-lease basis, had an average effective rate of percentage depletion of 24.9 percent. This was because a number of leases were subject to the 50-percent net income limitation. In 1954, under the 50-percent net income limitation, the effective depletion rate on a lease basis was 24.7 percent. In 1954, after recomputing percentage depletion using the operating unit principle, the 50-percent limitation was avoided to the extent that the effective rate of percentage deple-

tion for the same properties rose to better than 26 percent. This increased the percentage depletion allowance for 1954 by \$5,307,782 or by approximately 5.5 percent.

Company Y averaged an effective percentage depletion rate of 24.3 percent on the lease basis for years prior to 1954. In 1955, using the operating unit principle, the depletion rate was increased to 25.35 percent. Subsequently, company Y filed an amended tax return for 1955, claiming a larger operating unit and a larger aggregation of properties therein. This change increased the effective rate of percentage depletion to 26.3 percent. The change in 1955 from smaller aggregations to larger aggregations increased percentage depletion by \$3,480,184. At 1958-60 levels of production of company Y, an increase in the effective percentage depletion rate, by avoidance of the net income limitation, from 24.3 (lease basis) to 26.3 (broad aggregation basis) would increase annual percentage depletion by approximately \$10 million and reduce income taxes by more than \$5 million per year.

TABLE 1.—*Examples of aggregations claimed under operating unit approach, 1954-61*

Examples of operating units claimed <sup>1</sup>	Number of fields	Leases in unit			Length in miles	Breadth in miles
		Total	Aggregated	Nonaggregated		
Operating unit No. 1 (includes the whole State of Oklahoma).....	138	767	305	462	205	260
Operating unit No. 2 (includes the whole State of Kansas).....	127	487	228	201	265	320
Operating unit No. 3 (includes over 50 counties in Texas).....	112	549	194	355	285	255
Operating unit No. 4 (includes portions of Arizona, New Mexico, and Texas).....	45	914	512	402	250	190
Operating unit No. 5 (includes the whole States of Illinois, Indiana, and Kentucky).....	74	591	432	159	180	90
Operating unit No. 6 (includes over 40 counties in Texas).....	72	488	266	222	225	165
Operating unit No. 7 (includes portions of Arizona, Utah, Colorado, New Mexico and Texas).....	51	506	192	314	595	180
Operating unit No. 8 (includes over 15 counties in Texas).....	108	330	126	210	158	150
Operating unit No. 9 (includes the entire Province of Alberta, Canada).....	36	( <sup>2</sup> )	( <sup>2</sup> )	( <sup>2</sup> )	575	825

<sup>1</sup> These are examples of operating units used by several oil companies in filing their final income tax returns. A company may have any number of operating units depending on the scope of its operations.

<sup>2</sup> Unknown.

Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

Source: Corporate tax returns and supporting schedules, 1954-61.

## EXHIBIT 10

### TREATMENT OF CAPITAL GAINS AND LOSSES

Table 1. History of the tax treatment of capital gains and losses of individuals since 1922.

Table 2. History of the tax treatment of capital gains and losses of corporations since 1932.

Table 3. Amounts and percentages of net long-term capital gain among income classes, individual income tax returns, 1959.

Table 4. Net long-term capital gains, 1959, by type of gain, amounts and percent.

Table 5. Net long-term capital gains, 1959—Percentage distribution by type, for adjusted gross income classes.

Table 6. Realized net long-term capital gain as a percentage of total realized income, by income class, 1959 (taxable returns).

Table 7. Estimated revenue yield from capital gains and income taxation, 1948-1960.

Table 8. Comparison of effective rates of tax applicable to capital gains under present law and House Plan when fully effective (1965).

Table 9. Effect of the House bill—50-40 percent inclusion, 21 percent alternative rate provision for 1964, 1965, 1966, 1967, and long-run tax liabilities.

TABLE 1.—History of the tax treatment of capital gains and losses of individuals since 1922

Revenue Act of—	Income year	Provisions with respect to—					
		Assets by period held	Percent of gain or loss taken into account in computing net income	Tax on net gain taken into account	Loss offsets, limitations, and carryovers		
1921	1922-23	More than 2 years.....	100	At the election of the taxpayer, capital net gains were taxable at 12½ percent in lieu of the normal and surtax rates.	Capital losses allowed in full against income of any kind.		
1924	1924	No change.....	100	do.....	Capital losses could be segregated from ordinary net income, and a tax credit of 12½ percent of the net capital loss taken, but in no case could the tax be less than the tax (computed at normal and surtax rates) would be if the capital net loss were deducted from ordinary net income.		
1926	1926-27	} do.....	100	No change.	No change.		
1928	1928-31						
1932	1932-33						
1934-36	1934-37						
		1 year or less.....	100	} Net capital gains to the extent thus recognized were included in net income subject to full normal and surtax rates.	} Net capital losses computed on basis of foregoing percentages were allowed in determining net income to the extent of the recognized capital gains plus \$2,000.		
		Over 1 year, not over 2 years.....	80				
		Over 2 years, not over 5 years.....	60				
		Over 5 years, not over 10 years.....	40				
		Over 10 years.....	30				
	1933-41	Short-term: Not more than 18 months.....	100	Net short-term gain fully taxable at normal and surtax rates. In 1940 defense tax also applied.	Short-term loss allowed only to extent of short-term gain. Loss disallowed in 1 year (to an amount not in excess of net income) carried forward and applied against net short-term gain of the succeeding year.		
		Long-term: More than 18 months but not more than 24 months.....	66½	} Net long-term gain either included with other income subject to normal and surtax rates or segregated and taxed at 30 percent, whichever method results in the lesser tax. In 1940 defense tax also applied.	} Long-term loss allowed against long-term gain. Net long-term loss either deducted from other income (including net short-term gain) or 30 percent of net loss credited against tax on other income, whichever method results in the greater tax. No long-term loss carryover.		
		More than 24 months.....	50				
1942	1942-51	Short-term: Not more than 6 months.....	100	Net short-term gain (reduced by net long-term loss taken into account) fully taxable at normal and surtax rates.	} Short-term loss combined with long-term loss taken into account allowed to the extent of (1) short-term gain, (2) long-term gain taken into account, and (3) other income up to \$1,000. Balance of combined short- and long-term net loss carried forward for 5 years as short-term loss. The amount of the net capital loss carryover may not be included in computing a new capital loss of a taxable year which can be carried forward to the next 5 succeeding taxable years.		
		Long-term: More than 6 months.....	50	Net long-term gain (reduced by net short-term loss) either included with other income subject to normal and surtax rates or segregated and taxed at 50 percent, whichever method results in lesser tax.			

1951	1952-53	No change-----	0	No change in treatment of short-term gains. Net long-term gains included with other income subject to normal tax and surtax rates, or segregated and taxed at a maximum rate of 52 percent, whichever method results in the lesser tax.	Short-term losses must be offset against long-term gains before the 50-percent exclusion. Full allowance for net long-term losses against ordinary income up to \$1,000. 5-year carryforward unchanged.
1954 <sup>1</sup>	1954-58	do-----	0	No change in treatment of short-term gains. Net long-term gains included with other income taxable at regular rates, or segregated and taxed at a maximum of 50 percent, whichever method results in the lesser tax.	No change.

<sup>1</sup> Internal Revenue Code.

TABLE 2.—History of the tax treatment of capital gains and losses of corporations since 1932<sup>1</sup>

Revenue Act of—	Income year	Period held	Treatment of capital gain	Treatment of capital loss
1932	1932-33	2 years or more.....	Included in net income and taxed at regular rates.....	Entirely deductible.
1934	1934-37	Regardless of period held.....	do.....	Limited to amount of capital gains plus \$2,000 or to the amount of the capital loss, whichever is less.
1938	1938-39	do.....	do.....	No change.
1939	1940-41	Short-term: 18 months or less.....	do.....	Short-term capital losses are allowed in the current year only to the extent of the short-term capital gains, the excess short-term capital losses (in an amount not in excess of the net income for such current year) being allowable against the short-term capital gains of the 1st succeeding taxable year only, and to the extent that such short-term gains have not already been offset by the short-term capital losses of such 1st succeeding taxable year.
		Long-term: More than 18 months.....	do.....	Long-term capital losses are entirely deductible.
1942	1942-43	Short-term: 6 months or less.....	do.....	Short-term capital losses are allowable against both short- and long-term capital gains of the current year.
		Long-term: More than 6 months.....	Included in net income and taxed at regular rates unless the long-term capital gain exceeds the short-term capital loss in which case the corporation may pay the alternative tax if such alternative tax is less than the tax at the regular rates. The alternative tax is the sum of (1) the regular tax on net income reduced by the amount of the excess of net long-term capital gain over net short-term capital loss and (2) 25 percent of such excess.	Long-term capital losses are allowable against both long- and short-term capital gains of the current year. For the purpose of determining the extent of deductibility of capital losses in the taxable year, all short-term and long-term gains and losses taken into account are considered together, and losses—long term or short term—are deductible only to the extent of the aggregate gains—long term and short term. Any undeductible excess of capital loss may be carried forward into the next 5 succeeding years until it is absorbed by the "net capital gains," defined as the excess of all gains (long term and short term) from sales or exchanges of capital assets over losses (long term and short term) from such sales or exchanges.
1943	1944-51	No change.....	No change except that for 1944-45, the excess of net long-term capital gain over net short-term capital loss is excluded from net income for declared value excess profits tax. The treatment for income tax purposes is not affected by this change.	No change.
1951	1952-53	do.....	Alternative rate increased to 28%.....	Do.
1954 <sup>2</sup>	1954-	do.....	Alternative rate 26% for taxable years beginning before April 1, 1954, 25% for years beginning after March 31, 1954.	Do.

<sup>1</sup> For 1931 and prior years, no distinction was made between the ordinary profits of a corporation and the occasional profits from the sale of assets.

<sup>2</sup> Internal Revenue Code.



TABLE 3.—Amounts and percentages of net long-term capital gain among income classes, individual income tax returns, 1959

Adjusted gross income classes	Amount of gains (thousands)	Percent of total gains	Average gain on returns in class reporting capital gains	Percent of all returns in class reporting capital gains/loss
Total.....	\$12,331,867	100.0	\$2,516	8.1
Under \$10,000 <sup>1</sup> .....	3,552,976	28.8	1,100	5.8
\$10,000, under \$50,000.....	4,350,166	35.3	3,428	29.0
\$50,000, under \$100,000.....	1,454,337	11.8	15,712	82.4
\$100,000, under \$500,000.....	1,991,358	16.1	87,346	85.7
\$500,000 or more.....	983,030	8.0	1,028,242	95.8

<sup>1</sup> Includes returns with no adjusted income.

TABLE 4.—Net long-term capital gains, 1959, by type of gain, amounts and percent—Individual returns

[Dollar amounts in thousands]

	Amount of net long-term capital gain	Percent of total long-term gain
Total net long-term capital gain.....	\$12,331,867	100.0
Corporation stocks, including rights.....	5,116,261	41.5
Bonds and notes.....	189,480	1.5
Distributions from regulated investment corporations.....	360,371	2.9
Share of gain or loss from partnerships and fiduciaries.....	1,010,202	8.2
Livestock.....	701,116	5.7
Natural resources <sup>1</sup> .....	262,593	2.1
Machinery, buildings, and other assets used in trade or business.....	537,631	4.4
Real estate.....	2,217,439	18.0
Other capital assets.....	1,930,775	15.7

<sup>1</sup> Includes timber and timber royalties; oil and mineral rights and leases; coal royalties; oil well ventures; and production payments in oil and minerals.

TABLE 5.—Net long-term capital gains, 1959, percentage distribution by type, for adjusted gross income classes

	Income classes [in thousand dollars]						Gain as a percent age of gross sales <sup>1</sup>
	0 to 10	10 to 50	50 to 100	100 to 500	500+	All	
Security-type gains.....	30.4	55.9	67.3	70.3	78.4	51.1	-----
Securities.....	19.4	43.1	55.2	61.6	72.4	43.0	25.6
Corporation stocks.....	19.1	41.7	53.4	59.8	70.5	41.4	29.3
Bonds.....	.3	1.4	1.8	1.8	1.9	1.6	7.1
Distributions from regulated investment companies.....	3.8	4.0	2.2	0.7	0.4	2.9	-----
Gain from partnerships and fiduciaries.....	7.2	8.8	9.9	8.3	5.6	8.2	-----
Real estate.....	29.4	18.2	11.3	10.2	1.5	18.0	22.2
Business buildings, machinery.....	5.9	5.8	2.2	1.5	1.0	1.4	22.3
Livestock.....	16.3	2.2	1.0	0.5	0.1	5.7	71.5
Natural resources.....	3.5	1.2	0.8	1.7	2.6	2.1	68.7
Other.....	13.9	16.6	17.3	15.6	16.2	15.7	-----
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	-----

<sup>1</sup> Where such data are given.

NOTE.—Individual items may not add to column totals because of rounding error.

Source: Statistics of Income, "Sales of Capital Assets Reported on Individual Income Tax Returns," 1959.

TABLE 6.—Realized net long-term capital gain as a percentage of total realized income<sup>1</sup> by income class, 1969 (taxable returns)

Adjusted gross income classes:	Thousands
\$5,000 to \$10,000.....	\$1.3
\$10,000 to \$15,000.....	3.3
\$15,000 to \$20,000.....	6.6
\$20,000 to \$25,000.....	8.8
\$25,000 to \$50,000.....	11.5
\$50,000 to \$100,000.....	18.8
\$100,000 to \$150,000.....	31.5
\$150,000 to \$200,000.....	40.0
\$200,000 to \$500,000.....	50.2
\$500,000 to \$1,000,000.....	63.0
\$1,000,000 upward.....	63.8

<sup>1</sup> Realized income is the sum of adjusted gross income and the half of net long-term capital gains excluded from the computation of adjusted gross income on individual tax returns.

TABLE 7.—Estimated revenue yield from capital gains and income taxation, 1943-60

[In billions of dollars]

Calendar year of liability	Individuals and fiduciaries			Corporations				Individuals, fiduciaries, and corporations		
	Total income taxes <sup>1</sup>	Estimated tax on capital gains and losses		Total income and excess profits taxes <sup>1</sup>	Estimated tax on capital gains and losses		Total income and excess profits taxes	Estimated tax on capital gains and losses		
		Amount	Percent of total tax <sup>2</sup>		Amount	Percent of total tax <sup>2</sup>		Amount	Percent of total tax <sup>2</sup>	
1948.....	15.6	0.6	3.8	11.9	0.2	1.7	27.5	0.8	2.9	
1949.....	14.7	.4	2.7	9.8	.2	2.0	24.5	.6	2.4	
1950.....	18.6	.9	4.8	17.3	.3	1.7	35.9	1.2	3.3	
1951.....	24.4	.9	3.7	22.1	.3	1.4	46.5	1.2	2.6	
1952.....	28.0	.8	2.9	19.1	.3	1.6	47.1	1.1	2.3	
1953.....	29.7	.7	2.4	19.9	.3	1.5	49.6	1.0	2.0	
1954.....	26.9	1.1	4.1	16.9	.5	3.0	43.8	1.6	3.7	
1955.....	29.9	1.0	5.4	21.7	.5	2.3	51.6	2.1	4.1	
1956.....	33.1	1.5	4.5	21.4	.5	2.3	54.5	2.0	3.7	
1957.....	34.8	1.3	3.7	20.8	.4	1.9	55.4	1.7	3.1	
1958.....	34.7	1.4	4.0	18.8	.6	3.2	53.5	2.0	3.7	
1959.....	40.0	2.3	5.8	22.5	.4	1.9	62.5	2.7	4.3	
1960.....	39.8	1.9	5.0	21.9	.5	2.2	61.7	2.4	3.9	

<sup>1</sup> As reported in "Statistics of Income."

<sup>2</sup> Derived from rounded data.

NOTE.—The estimated tax on capital gains and losses for each of the specified years is the difference between (1) the total individual and corporation income taxes reported in "Statistics of Income" and (2) the total of such taxes which would have been realized if capital gains and losses had been entirely exclude from the tax computation.

Estimates of capital gains tax revenue are subject to a rather significant margin of error for individuals. These estimates are approximations of the effect upon tax liabilities of a recomputation of tax excluding the amount reported as capital gains and losses. These gains and losses are treated as final sources of income or deduction and therefore the revenue effect is based on marginal rates. In addition, the estimates are based upon summary data. The possible error is reduced somewhat where cross classifications by size of adjusted gross income and size of capital gain income or loss are available.

TABLE 8.—Comparison of effective rates of tax applicable to capital gains under present law and House plan when fully effective (1965)

Taxable income bracket (thousand dollars)	Percent gain on sale of assets held—				
	Present law		Proposed plan		
	Not more than 6 months	Over 6 months	Not more than 6 months	Between 6 months and 2 years <sup>1</sup>	Over 2 years <sup>2</sup>
0 to 0.5.....	20	10.0	14	7.0	5.6
0.5 to 1.0.....	20	10.0	15	7.5	6.0
1.0 to 1.5.....	20	10.0	16	8.0	6.4
1.5 to 2.0.....	20	10.0	17	8.5	6.8
2 to 4.....	22	11.0	19	9.5	7.6
4 to 6.....	26	13.0	22	11.0	8.8
6 to 8.....	30	15.0	25	12.5	10.0
8 to 10.....	34	17.0	29	14.5	11.6
10 to 12.....	38	19.0	32	16.0	12.8
12 to 14.....	43	21.5	36	18.0	14.4
14 to 16.....	47	23.5	39	19.5	15.6
16 to 18.....	50	25.0	42	21.0	16.8
18 to 20.....	53	25.0	45	22.5	18.0
20 to 22.....	56	25.0	48	24.0	19.2
22 to 26.....	59	25.0	50	25.0	20.0
26 to 32.....	62	25.0	53	25.0	21.0
32 to 38.....	65	25.0	55	25.0	21.0
38 to 44.....	69	25.0	57	25.0	21.0
44 to 50.....	72	25.0	60	25.0	21.0
50 to 60.....	75	25.0	62	25.0	21.0
60 to 70.....	78	25.0	64	25.0	21.0
70 to 80.....	81	25.0	66	25.0	21.0
80 to 90.....	84	25.0	68	25.0	21.0
90 to 100.....	87	25.0	69	25.0	21.0
100 to 150.....	89	25.0	70	25.0	21.0
150 to 200.....	90	25.0	70	25.0	21.0
200 and over.....	91	25.0	70	25.0	21.0

<sup>1</sup> 50-percent inclusion, 25-percent maximum.<sup>2</sup> Class A gains only, 40-percent inclusion, 21-percent maximum.

TABLE 9.—Effect of the House bill, 50-40 percent inclusion, 21-percent alternative rate provision for 1964, 1965, 1966, 1967, and longrun tax liabilities

[In millions of dollars]

	Calendar years				
	1964	1965	1966	1967	1968 and longrun
Direct effects of reduced inclusion percentage and lower maximum rate.....	-230	-230	-230	-230	-230
INDUCED EFFECTS					
Unlocking of capital gains from reduced inclusion percentage and lower alternative rate.....	+520	+320	+195	+150	+100
Deferral effect on gains between 6 months and 2 years.....	-80	-10	-10	-10	-10
Total induced effects.....	+440	+310	+185	+140	+90
Total effects.....	+210	+80	-45	-90	-140

## EXHIBIT 11

## REAL ESTATE TAX SHELTERS

## A. INTRODUCTION

The provision of I.R. 8363 dealing with real estate tax shelters is directed at a weakness in existing law which has been systematically exploited by some of the various syndicates and similar arrangements in this field. The weakness is found in the interplay between excessive depreciation under the accelerated methods of depreciation and capital gains treatment of profits reflecting such excessive prior writeoffs which are realized on relatively quick resale of real estate.

Section 220 of the bill would—

1. Treat gain on sale after December 31, 1963, of real property held 1 year or less as ordinary income to the extent of depreciation with respect to periods after December 31, 1963.

2. In the case of real property held more than 1 year, treat gain on its disposition as ordinary income to the extent that depreciation taken with respect to the property exceeds the depreciation deductions allowable under the straight line method of depreciation (referred to as "additional depreciation"), subject to a sliding scale cutoff as follows:

On property held more than 12 months but not more than 20 months, gain would be ordinary income to the extent of the additional depreciation for periods after 1963.

On property held more than 20 full months, the percentage of gain reflecting such additional depreciation to be treated as ordinary income would be reduced by 1 percentage point for each month the property has been held beyond 20 full months. After 10 years, all gain would thus be treated as capital gain.

This provision will correct the serious abuses without interfering with legitimate real estate investment and development. It will reduce the significance of artificial tax factors which are fostering increasingly unhealthy ventures and financial practices contrary to the best long-range interests of the real estate industry and its investors.

## B. THE REAL ESTATE TAX SHELTER PROBLEM

The nature of the problem of real estate tax shelters and the dangers inherent in the existing situation are summarized in a recent article in the financial press as follows:

"At present a real estate company can buy or build a structure, quickly write off its cost against taxable income, and distribute the untaxed income to stockholders; the stockholders pay no tax because the distributions are considered a return of capital rather than dividends. The company can then sell the building to a new owner who can start the same process over again. The selling company would pay a capital gains tax on the difference between the building's depreciated value at the time of sale and the sale price it received."<sup>1</sup>

Other astute and informed observers have pointed to undesirable trends developing in real estate financing. These include gross overvaluation of properties, excessive burdening of the properties with mortgage indebtedness, and the formation of highly complex and unstable financial structures. These conditions are directly traceable to systematic efforts to exploit to the utmost the possibilities of developing tax-free income from accelerated tax depreciation, followed by resale of the written down property and realization of capital gains reflecting past depreciation in excess of straight line depreciation.

The nature of the real estate tax shelter is epitomized in an article in the financial press under the descriptive heading:<sup>2</sup>

## "PROFITS IN LOSSES

"REAL ESTATE INVESTORS TURN DEPRECIATION TAX WRITEOFFS INTO GAINS—KRATTER CORP. SHOWS A LOSS, BOOSTS PAYMENTS ON STOCK; LENDERS SHARE IN PRO- A MAJOR RISK: OVERBUILDING"

This article begins:

"Last year was a good one for the Kratter Corp., a real estate investment company; it was able to show a net loss of \$1,762,240.

<sup>1</sup> Wall Street Journal, Jan. 30, 1963, p. 22.

<sup>2</sup> By Stanley W. Penn, Wall Street Journal, July 17, 1961.

"Kratzer's directors, pleased with the 1960 performance, raised the company's cash distribution to stockholders three times during the year. If all goes well, Kratzer will show another deficit for 1961 and it's even possible that payments to stockholders will be increased again.

"The seeming contradictions here have a ready explanation: Kratzer, and companies like it, are able to write down the value of the properties they own so heavily and rapidly that they can show a bookkeeping loss yet at the same time generate a large cash flow—that is, operating income plus depreciation. Stockholders like it this way; so long as the companies show no earnings, their payments are considered returns of capital (Kratzer does not use the word 'dividends') and are not subject to income tax."

#### C. THE DEPRECIATION FEATURE AS A FACTOR IN THE REAL ESTATE TAX SHELTER

The role of depreciation in the tax shelter is explained in the Penn article (cited above) as follows:

"A big attraction of the syndicates and the publicly held real estate investment companies is the depreciation feature. Under the tax laws, improved real estate is considered to depreciate from wear and tear as years go by even if the market value of the property is rising, as well-situated improved real estate has been in recent years. To compensate for the depreciation, a tax deduction can be taken off real estate income—although, of course, the income itself is not affected.

"There are several methods of figuring depreciation. Under what is known as the straight-line method, a fixed percentage is deducted from the cost of a property every year throughout what is decided in advance to be its reasonably useful life. Thus, if an office building, for example, has an anticipated life of 50 years, it can be depreciated at 2 percent of the original investment a year; after 50 years, the original cost would be fully written off. If the building cost \$2 million, the yearly depreciation would be \$40,000.

"Many real estate syndicates and investment companies, however, use an accelerated method of depreciation under which they make deductions at one and a half times the straight-line rate. The accelerated rate is applied each year to the value remaining on the books. An office building with a reasonably useful life of 50 years could be depreciated at 3 percent; in this case, the depreciation for the first year would be \$60,000, for the second year \$58,200 (3 percent of the depreciated value of \$1,940,000), and so on. First users of properties are allowed an even faster writeoff under accelerated depreciation; they can depreciate at twice the straight-line rate, or at 4 percent in the preceding example.

"Under these accelerated methods, the writeoffs are largest in the first year and decline thereafter. For a property held only 5 years, the choice of depreciation method can make a considerable difference. On a \$2 million property, \$200,000 can be depreciated in that time under the straight-line method. But \$282,531 can be written off at the 3-percent rate and \$369,254 at 4 percent."

#### D. RE SALE AT CAPITAL GAINS RATES BEFORE PROPERTY SHOWS TAXABLE INCOME

As further explained in the Penn article, the rapid depreciation feature combined with the availability of capital gain treatment on resale "has made it attractive for many real estate investors to take the highest possible depreciation rate on an income-producing property and then sell the property after, say 6 or 7 years when the property nears the point of showing a taxable profit. The new buyer then may start all over again, using a fast writeoff with the intention of selling later himself. Since the fastest possible depreciation can be obtained on a new property, it often is to the advantage of the investor to build."

#### E. ILLUSTRATIONS OF REAL ESTATE TAX SHELTER OPERATIONS

##### 1. Corporate operations

The following excerpt from the Penn article illustrates the method of operation of a real estate corporation which uses fast depreciation writeoffs to eliminate taxable income:

"To see how the big writeoffs affect a real estate company's financial statement, take another look at Kratzer. In the Kratzer statement for 1960, total revenues, consisting mainly of rentals, were \$9,997,043. Deductions, including operating expenses and interest on mortgages, came to \$4,836,671, leaving an income before depreciation of \$5,160,372. However, depreciation and amortiza-

tion for income-tax purposes amounted to \$3,922,612. Deduct this from \$5,100,372 and you have the company's net loss of \$1,762,240.

"PAYMENTS TO STOCKHOLDERS

"Kratzer follows a policy of paying to its shareholders practically all of its predepreciation income; in 1960, Kratzer paid \$5,122,470 in nontaxable distributions.

"The question arises, in view of this almost complete payout of predepreciation income, how can the company reduce mortgage debt and generate funds for new ventures? There are several ways. In April 1960, Kratzer sold \$23,488,160 of preferred stock, investing the proceeds. The company also sells its investments when it deems it advantageous to do so. In 1960, for example, it sold a leasehold on a property at Long Beach, Calif., for \$575,000; the cost of the property, including improvements, was \$359,000. Kratzer also expects from time to time to refinance its mortgages in larger amounts, and the company says it is able to obtain unsecured loans from commercial banks at 'relatively low' rates of interest."

Operations of the Kratzer Corp. are further explained in an earlier New York Times article of May 31, 1959, reproduced below :

"[From the New York Times, May 31, 1959]

"PROFITABLE LOSS IS COMPANY'S AIM—KRATZER CONCERN COMBINES SEVEN REAL ESTATE GROUPS AND EYES TAX GAINS

"(By Burton Crane)

"Stationary shops carry humorous signs: 'This is a nonprofitmaking organization. We didn't plan it that way but that's how it turned out.' Kratzer Corp., which started business a month ago, seems to have been planned that way.

"It is a combination of several real estate syndicates holding properties with a gross value estimated between \$63 and \$75 million. It seems to have been organized in such a way that it will show an operating loss for the greater profit of its stockholders. It does this by taking advantage of the accelerated depreciation schedules allowed by the Federal income tax authorities.

"PROPERTIES ARE RENTED

"The real estate properties are mostly rented on a net leased basis. That is, the tenant pays real estate taxes and upkeep expenses. The holdings include such properties as the Kratzer Building at 112 West 34th Street, running through the block and therefore across the street from both the R. H. Macy store on 34th Street and the Gimbel Bros. store on 35th Street. Among others are the Pratt & Whitney plant at West Hartford, Conn.; the Western Merchandise Mart in San Francisco, and the Lunt-Fontanne Theater, 205 West 46th Street, New York.

"For some years Marvin Kratzer has been organizing real estate syndicates in which small investors might participate. They were designed to take advantage of the depreciation rules and to return to their partners 10 to 15 percent a year. The Kratzer Corp. offered diversification and a readier market for shares to about 2,000 syndicate partners. About 84 percent of the shares of these syndicates was turned over to the Kratzer Corp. in exchange for Kratzer shares. According to the latest count, Kratzer now has about 5,000 shareholders.

"HERE'S AN EXAMPLE

"For some years large real estate operators have been using the depreciation rules for their greater profit. The following example shows how these might work:

"A plant bought for \$12 million and depreciable over 16½ years would have depreciation of 6 percent a year or \$720,000 a year under the usual straight-line method. Under the 150 percent declining balance method, depreciation in the first year would be \$1,080,000, or 9 percent of \$12 million. In the following year it would be 9 percent of the unpaid balance, or \$982,800; in the following year \$894,300, and so on.

"For the purposes of the example, it is assumed that there are mortgages of \$6 million on this property. Interest and amortization over, say, 25 years, are on an equal-payment basis of about \$350,000 a year.

"Debt service and depreciation in the first year amount to \$1,430,000 and net rental income, for the sake of the example, to \$1,250,000. The net loss is \$180,000 a year.

**"ONLY FOR BOOKKEEPING**

"Depreciation, however, is only a bookkeeping item. After paying debt service of \$350,000, the syndicate has \$900,000 cash remaining. Out of this it makes a payment of \$480,000—8 percent on the original equity of \$6 million—to its partners. This enjoys the tax-free status of a return of capital, since it is not a distribution of profits.

"The Kratter Corp.'s prospectus—the stock issue has a prospectus but was made without any public offering, by an exchange offer to syndicate partners—points out that income from net leases will probably top the dwindling depreciation allowances by the end of next year. But because of tax-loss carry-forwards, the corporation may not be obligated to pay any Federal income taxes until about 1964.

"Before then, the company would expect to be able to sell the original properties and start the same depreciation procedure with new properties. If a property were sold for its original cost the corporation would have to pay a long-term capital gains tax of 25 percent on the amount of the depreciation it had charged off. In the example above, depreciation of the \$12 million plant over 4 years would amount to \$3,861,870 and the capital gains tax to about \$965,500, provided the property were sold for its cost price. In this example, then, the shareholders would have received about \$1,920,000 tax free and would have seen the book value of their property reduced about half that. But a rise in the sales price might even wipe out the book value loss.

"Kratter Corp. got underway early in March when Mr. Kratter and some close associates bought all its 300,000 shares of class B stock for \$300,000—its par value is \$1 a share—and 250,000 shares of the \$10 par value class A stock for \$2,500,000. The class B stock elects two-thirds of the directors, the class A stock, as a class, one-third. There are 2,719,950 shares authorized.

**"SHARES WERE EXCHANGED**

"The company then made an exchange offer for investment units in the syndicates and about 2,500,000 shares are now outstanding. The class B stock is convertible into class A stock. By March 31, 1964, in any event—and at any time after the beginning of next year if the number of class B shares falls below 100,000—the distinction between class A and class B stocks will be wiped out. All will have equal voting power and par value of \$1 a share."

**2. Individual tax shelter arrangements**

Individual investments in real estate tax shelters are described and explained in the following excerpts from an article in the St. Louis Post-Dispatch of November 22, 1959, under the title:

**"AMAZING TAX SHELTER DEALS' IN REAL ESTATE EXPLAINED TO APPRAISAL INSTITUTE**

"In these days of big tax shelter deals in real estate, amazing transactions taking place are shown in a series of case studies presented during the annual convention of the American Institute of Real Estate Appraisers.

"As an example of seemingly absurd but actually quite sound transactions, in the light of income tax consideration, is the example of a wealthy investor in an extremely high tax bracket. He paid \$3,190,000 for a 23-story office building in an eastern city on which the 'cash flow' to him for the next 19 years will be exactly zero.

"For the first 6 years, the total of mortgage interest and depreciation actually will exceed the net rental, resulting in no taxable income from [the] equity investment \* \* \*.

"From the seventh year, the taxable portion of the amortization payment increases each year," said the report, prepared by a special committee \* \* \*.

"Accordingly, there is a strong motivation for the investor to resell after 6 years. Resale after 6 years to avoid taxation on income earmarked for mortgage amortization is becoming a common pattern involving many large real estate sales."

"Motivating factor in the unusual deal, the report pointed out, was 'to defer normal income for a period of years while accumulating additional equity which might be disposed of at a later date as a capital gain. Another incentive was a net loss for tax purposes which might be used as an offset against the investment income from other sources.'

"Another instance was of another wealthy individual in a 65-percent tax bracket seeking more 'spendable income through equity investment' in real estate. By investing \$180,000 cash to acquire 10 stores worth \$1,800,000, he will be able to accumulate a tax loss of \$459,000 within 11 years.

"'At this point the tax advantage disappears and the purchaser will likely dispose of the property and probably realize a capital gain,' the study pointed out.

"By the end of the fourth year, this investor will have accumulated a tax loss of \$205,688. On the basis of his 65-percent tax bracket, this is equivalent to returning all of the \$180,000 he originally invested in the property, is the conclusion \* \* \*.

"\* \* \* One of the case studies presented at the AIRMA convention tells of three individuals, each of whom put up \$100,000 to make a downpayment on a \$1,750,000 shopping center. The annual 'cash throwoff' after mortgage payments is estimated at \$41,000, equivalent to a return of approximately 14 percent on their equity.

"However, they too are keeping an eye on the tax collector. 'Only \$15,800 of the \$41,000 is taxable the first year, but the taxable amount will increase as mortgage interest and depreciation decrease,' the report concludes."

#### F. HOW THE HOUSE BILL WILL DEAL WITH THE REAL ESTATE TAX SHELTER PROBLEM

The solution embodied in section 220 of H.R. 8363 deals with the basic cause of abuse in the real estate tax shelter area: the interplay of accelerated depreciation and capital gain treatment on profits reflecting excessive prior writeoffs.

The provision will not be retroactive since it will apply only to gains realized beginning in 1964 to the extent of depreciation with respect to the period since 1963.

The provision in section 220 is focused on the primary area of abuse: the quick resale of real estate. The sliding-scale cutoff beginning after property has been held 20 months will gradually reduce the application of ordinary gain treatment on longer term holdings and retain capital gain treatment in full for bona fide long-range holdings after 10 years.

#### Illustration of depreciation deductions subject to recapture under sec. 220 (per \$100 of cost—30-year useful life)

Sale at end of year	Additional depreciation <sup>1</sup>		Applicable percentage <sup>2</sup>	Amount subject to recapture assuming gain equals additional depreciation	
	200-percent depreciation balance method	150-percent depreciation balance method		200-percent depreciation balance method	150-percent depreciation balance method
1	6.67	5.00	100	6.67	5.00
2	6.22	3.08	96	5.97	2.96
3	5.76	4.26	84	7.31	3.58
4	10.70	5.22	72	7.77	3.76
5	12.51	5.95	60	7.61	3.57
6	13.90	6.49	48	6.67	3.12
7	14.57	6.84	36	5.39	2.46
8	15.57	7.00	24	3.74	1.68
9	16.26	6.98	12	1.95	.84
10	16.61	6.80	0		

<sup>1</sup> Additional depreciation refers, in the case of sales during the 1st year real property is held—to the entire depreciation allowed prior to sale, and in the case of sales after the real property has been held 1 year—to cumulative depreciation with respect to the property which is in excess of the cumulative depreciation which would be allowable under the straight line method.

<sup>2</sup> Applicable percentage refers to the percentage of additional depreciation (or gain if smaller) which is to be treated as ordinary income on disposition of the property; e.g., 100 percent in the case of property held less than 21 full months, 99 percent in case of property held 21 full months, decreasing 1 percent for each succeeding full month the property is held until the percentage decreases to zero for property held 120 months or 10 years.



## EXHIBIT 12

## INCOME AVERAGING

Section 221 of the House bill provides averaging of income for taxpayers with fluctuating income. Basically, this provision allows the averagable income to be taxed at the rate brackets applicable to the first one-fifth of the income. This gives approximately the same results as though the averagable income had been received in equal amounts in the current and prior 4 years.

*Example I*

A, an unmarried individual, is an author. His income in the computation year and in the 4 base-period years is all from royalties on books he has written.

## Taxable income:

1960.....	\$2,000
1961.....	4,000
1962.....	8,500
1963.....	2,500
1964.....	<u>44,000</u>
Average base-period income (1960-63).....	\$3,000

The taxpayer is eligible for averaging since (1) his taxable income for the current taxable year (\$44,000) exceeds 133 $\frac{1}{3}$  percent of his average taxable income for the prior 4 years (\$4,000); and (2) that excess amount (\$40,000) is greater than \$3,000. His tax liability for the current year would be computed as follows:

(1) Current income.....	\$44,000
Less 133 $\frac{1}{3}$ percent of average base-period income.....	4,000
Averagable income.....	<u>40,000</u>
(2) 133 $\frac{1}{3}$ percent of average base-period income.....	4,000
Plus one-fifth of averagable income.....	8,000
Total.....	<u>12,000</u>
(3) Tax on above total (\$12,000).....	3,040
Less tax on 33 $\frac{1}{3}$ percent of average base-period income (\$4,000).....	740
Tax on one-fifth of averagable income.....	<u>2,300</u>
(4) Tax on averagable income (\$2,300 $\times$ 5).....	11,500
Plus tax on 133 $\frac{1}{3}$ percent of average base-period income.....	740
Tax liability for computation year.....	<u>12,240</u>

Without the benefit of income averaging, the tax liability of A for 1964 would be \$20,130. Thus, this provision would result in tax savings of \$7,890, or a tax reduction of 39.1 percent.

*Example II*

B, an unmarried individual, is a rancher whose income increases in 1964 due to a rise in cattle prices. All of B's income is subject to tax at ordinary income rates.

## Taxable income:

1960.....	\$2,000
1961.....	4,000
1962.....	8,500
1963.....	2,500
1964.....	<u>44,000</u>
Average base-period income (1960-63).....	\$3,000

B's tax for 1964 under the income-averaging provision would be \$2,620, computed as in example I. Without the benefits of income averaging, B's tax for 1964 would be \$3,040. Thus, this provision results in a tax savings of \$420, or a tax reduction of 13.8 percent.

*Example III*

C, an unmarried individual, is an attorney, all of whose income is earned from the practice of law. C's income for 1964 increases substantially as a result of the collection of a contingent fee from a litigation on which C has been working for a period of 4 years.

## Taxable income:

1960-----	\$12,000
1961-----	14,000
1962-----	15,000
1963-----	10,000
1964-----	80,000
Average base-period income (1960-63)-----	15,000

Under the averaging provision, C's tax liability for 1964 would be \$30,000, computed as in example I. Without the benefits of income averaging, C's tax liability for 1964 would be \$44,400. Thus, this provision would result in a tax savings of \$5,400, or a tax reduction of 12.4 percent.

## EXHIBIT 13

## MULTIPLE INCORPORATION

## PART I. PRESENT ABUSES—MULTIPLE INCORPORATION CASES

This exhibit presents a wide variety of examples of actual cases involving the use of multiple corporations. These cases are not the result of an exhaustive search for all such cases which may exist. Rather, they are a diversified collection of cases reported by the various district offices of the Internal Revenue Service to illustrate the present tax benefits derived from multiple incorporation by essentially large enterprises consisting of a number of separately incorporated units or outlets.

The cases presented include both parent-subsidiary groups and brother-sister groups. Parent-subsidiary cases represent groups of corporations owned 80 percent or more by a common parent corporation. However, groups filing consolidated tax returns are not included. The brother-sister cases included represent groups of corporations owned 80 percent or more by one individual, or by a single family.

The schedule attached describes each case in terms of the nature of the business, administrative centralization, and ownership. The number of corporations belonging to each group is given to indicate the degree of multiple incorporation involved. In addition, certain tax information is given on each case computed under both present tax rates and the new tax rates effective for corporations in 1965 viz., a 22-percent normal tax and a 20-percent surtax. The tax liability under the new rates is reflected both with and without the 6-percent additional tax imposed under the House bill.

While the reported cases indicate a greater propensity toward multiple incorporation in certain industries, the variety of industries indicated demonstrates that these formations are not limited to any one industry. The relative degree of proliferation, however, in large part rests on the determination of the particular group, rather than on the particular industry to which the group is related. This can be illustrated by comparing the wide variation in corporate configurations for businesses competing in the same industry. The cases include a number of groups operating through a sizable number of constituent companies in the retail industry. However, there are a number of businesses competing in the same industry throughout the United States without the use of a highly proliferated corporate organization. A few of these businesses have been selected from "Moody's Industrial Manual" of 1962 for illustrative purposes, as follows:

J. C. Penney Co. operates 1,686 stores as branches, merchandising wearing apparel, dry goods, etc., in 49 States. The company also has one wholly-owned domestic subsidiary which operates a wholesale mail order business and a department store. In addition, the company has an inactive company and an active company to engage in foreign operations.

Montgomery Ward & Co., Inc. operates 517 general merchandise stores as branches located in 44 States and a nationwide mail order business. Company also has five 80-percent or more owned subsidiaries, including two real estate

companies, a credit company, a manufacturing company, and a retail company operating several department stores.

The Kroger Co. operates 1,354 food stores as branches located in 23 States and 18 drugstores. The company has one 80-percent-or-more owned subsidiary engaged in buying produce, etc.

The Great Atlantic & Pacific Tea Co., Inc., operates 4,409 food stores as branches located in 37 States. The company also owns directly three wholly owned domestic subsidiaries engaged in manufacturing and providing warehouse facilities, and two foreign corporations.

While it is apparent that, in a number of cases, the formation of multiple corporations was without regard to tax considerations, other cases indicate a strong tax motivation. This is indicated by the wide variation of tax savings obtained from multicorporate organization. In some instances the savings are incidental, while in others they are substantial. Under the present tax structure, the groups shown are subject to effective tax rates ranging from a low of 30 percent to a high of nearly 52 percent. The percentage tax reductions resulting from multiple surtax exemptions range from a low of 1.5 percent to a high of 42 percent.

With the lower normal tax rate proposed as part of the new rate schedule, the motivation toward multiple incorporation would be materially increased. Even where there is no deliberate intent to exploit surtax exemptions, the reversal of the rates would nevertheless result in an increase in the tax advantages for those large chain enterprises, resulting from tax benefits actually designed to help small independent businesses. With the proposed rates, the lower limit of the effective tax rate range would be reduced from 30 percent to 22 percent for certain groups. The significance of this reduction can be seen readily by a comparison of the tax reduction resulting from multiple surtax exemptions. In the absence of corrective measures the proposed rate reductions would increase the maximum tax savings of the multicorporate groups from 42 percent to 54 percent of the tax normally applicable in the absence of multiple exemptions.

The distribution of the various constituent multiple corporation companies in the actual cases contained in this exhibit, by size of net income, is shown below.

Size of income or loss	Number of constituent companies	Percent of total
Loss.....	1,178	23.0
0 to \$10,000.....	1,530	30.0
\$10,001 to \$25,000.....	1,199	23.5
\$25,001 to \$50,000.....	672	13.1
\$50,001 to \$100,000.....	242	4.7
Over \$100,000.....	291	5.7
Total.....	5,112	100.0

As the above table indicates, less than 24 percent of the constituent companies have taxable income above \$25,000. The clustering of companies in the \$25,000 or less income category suggests the substantial amount of income of these groups which is now being taxed only at the first bracket normal tax rate and which would be taxable at the combined normal and surtax rates if the chain of separate legal entities were viewed as a single large enterprise. The proposed rate reduction would increase the tax saving for each surtax exemption from the present \$5,500 to \$7,000 in 1964 and \$8,500 in 1965, if no penalties, or limitations were imposed. This increased value of the surtax exemption, when viewed in terms of the numbers of companies demonstrated within the sample groups, results in substantial tax savings to these and similar groups. Not only would this encourage further proliferation within existing multiple groups to maximize tax savings, but other businesses which have hesitated would have sufficient additional incentive to tip the scale toward multiple incorporation. With this development, the distribution for the above table would become even more heavily populated in the \$25,000 and under category. This would not only lose additional corporate revenues outside the small business sector, but also would aggravate existing disparities in effective tax rates among larger firms depending upon their form of organization.

For these reasons, unless corrective action is taken to limit the tax value of multiple surtax exemption to large firms, it would be impracticable to reduce the normal tax significantly in order to help small business.

## Examples of actual multiple incorporation cases

Case No.	Nature of business and ownership	Administration (management, financial, and legal functions), etc.	Number of corporations		Taxable income <sup>1</sup> (thousands)	Rates <sup>2</sup> (percent)	Computed tax <sup>3</sup> (thousands)	Effective tax rate (percent)	Tax saving from extra surtax exemptions <sup>4</sup> (thousands)	Percentage tax reduction resulting from extra surtax exemptions
			Parent, subsidiary	Brother, sister						
1	Retail sale of food products through about 50 stores. Owned by 1 family.	Centralized in 1 office. Each corporation operates generally 4 stores. Corporations use same trade name.		12	\$375	Present..... New: 22 to 48..... 28 to 48.....	\$155 133 144 306	41.3 35.4 33.3 44.0	\$36 41 30 86	18.4 23.5 17.2 14.5
2	Sale of beer, soft drink, and food at wholesale in 1 State. Owned by 1 family.	Centralized in 1 office. Certain of the companies are engaged in wholesale activities, while others own and rent either autos, trucks, land, or buildings to the operating companies.		19	1,150	Present..... New: 22 to 48..... 28 to 48.....	306 444 469	44.0 38.6 40.7	86 102 77	14.5 18.7 14.1
3	Fabrication and sale of furniture and fixtures. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Separate corporations were formed to manufacture each product. In addition, each sales outlet was separately incorporated. The same officers and directors serve all companies.	68		2,192	Present..... New: 22 to 48..... 28 to 48.....	938 815 869	42.8 37.3 39.7	193 229 174	17.0 21.9 16.7
4	Own and operate apartment buildings; corporations are owned by 1 family.	Centralized at 1 location. Each apartment house is separately incorporated.		14	279	Present..... New: 22 to 48..... 28 to 48.....	95 73 87	34.1 26.3 31.3	46 54 40	32.5 42.5 31.5
5	Corporations lease transportation equipment to the stockholders, plus furnishing facilities and repair services related thereto. The stockholders are a husband and wife who use these facilities in connection with a transport business.	Centralized at 1 location. Separate corporations were formed to own the leased property. Same officers and directors serve all corporations.		22	300	Present..... New: 22 to 48..... 28 to 48.....	105 64 98	35.0 28.0 32.6	45 54 40	29.8 39.0 28.9
6	Eating establishments in 14 areas. 80 percent to 100 percent owned by 1 individual.	Centralized in 1 management corporation. Same officers and directors serve all companies. Separate incorporation to control specific geographical areas.		14	991	Present..... New: 22 to 48..... 28 to 48.....	463 414 423	46.7 41.8 40.9	47 55 43	9.2 11.7 8.7
7	Chain of restaurants. In addition, catering services are offered. Corporations are owned by 1 individual.	Centralized with 1 company. Separate corporations were formed according to the service rendered. In addition, each restaurant is separately incorporated.		26	553	Present..... New: 22 to 48..... 28 to 48.....	215 187 205	38.9 33.8 37.0	67 72 54	23.8 27.9 20.9

8	Manufacturer and distributor of textiles. In addition, factors accounts receivable and operates a chain of 360 retail clothing stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized at 2 locations to segregate the manufacturing and retail operations. Separate corporations were formed for each manufacturing plant, for each retail store, and for the factoring business. The retail companies use the same name, followed by the city of location.	405				(9)		
9	Beauty salons located throughout the United States. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent which acts as a central purchasing agency. Each salon is separately incorporated and uses the same name, followed by the city of location.	250				(9)		
10	Fleet of taxicabs in 1 city. Parent is owned by 1 individual.	Centralized with a management company. Each operating company operates several cabs.	50	182	Present..... 55 New: 22 to 48..... 40 28 to 48..... 51	30.2 22.0 28.0	35 41 30	38.9 50.6 37.0	
11	Chain of 227 retail jewelry stores located in a number of States. Parent is controlled by 1 family, with minority stock publicly held. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. For the most part, each store is separately incorporated. In addition, a corporation was formed to handle purchasing. Substantially all companies use the same name, followed by the city of location.	191				(9)		
12	Finance business. Stock of parent is closely held. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Separate corporations were formed to conduct the finance business in each area of operation. Each corporation uses the same trade name.	92	1,063	Present..... 370 New: 22 to 48..... 295 28 to 48..... 344	34.8 27.7 32.4	177 209 159	32.4 41.5 31.6	
13	Finance business. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	do.	137	3,843	Present..... 1,559 New: 22 to 48..... 1,326 28 to 48..... 1,448	40.6 34.5 37.6	433 512 393	21.7 27.8 21.4	
14	Retail furniture stores in several cities. Corporations are owned by 1 family.	Centralized with one of the companies. Each store is separately incorporated using a variation of the same name. Same officers and directors serve all the companies.	23	700	Present..... 274 New: 22 to 48..... 236 28 to 48..... 259	39.1 23.8 37.1	88 93 70	21.5 28.3 21.3	
15	Retail stores at several hundred locations. Related activities include feeder-type plants to produce merchandise. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. The retail operations are conducted by separate companies which were incorporated to operate stores according to geographical area. Each of the other listed activities are conducted by 1 or more corporations. In addition, separate corporations were formed to provide warehousing facilities, packaging services, advertising services, and to own and rent real estate. Retail corporations use the same trade name.	143	18,840	Present..... 9,162 New: 22 to 48..... 8,299 28 to 48..... 8,471	48.6 44.0 45.0	629 737 566	6.4 8.2 6.3	

See footnotes at end of table, p. 216.

Examples of actual multiple incorporation cases—Continued

Case No.	Nature of business and ownership	Administration (management, financial, and legal functions), etc.	Number of corporations		Taxable income <sup>1</sup> (thousands)	Rates <sup>2</sup> (percent)	Computed tax <sup>3</sup> (thousands)	Effective tax rate (percent)	Tax saving from extra surtax exemptions <sup>4</sup> (thousands)	Percentage tax reduction resulting from extra surtax exemptions
			Parent, subsidiary	Brother, sister						
16	Retail and wholesale of merchandise, such as appliances and housewares. Parent is publicly owned. Subsidiaries are wholly owned by parent.	Centralized with the parent company. Same officers serve all companies. For the most part, each store is separately incorporated and each corporation uses the same trade name.	74	-----	\$4,229	Present..... New: 22 to 48..... 28 to 48.....	\$1,937 1,724 1,792	45.8 40.7 42.4	\$234 303 232	10.8 15.0 11.4
17	Chain of repair shops. Activities also include the operation of several supply houses. Corporations are owned by 1 individual.	Centralized with 1 service company which operates under a service agreement with the other companies to conduct all administrative and advertising functions. In addition to the service corporations, for the most part each repair shop is separately incorporated and uses the same trade name. Each supply house is separately incorporated. The sole stockholder is the president of all corporations.	-----	118	1,079	Present..... New: 22 to 48 percent. 28 to 48 percent.	364 286 339	33.7 26.5 31.4	191 226 172	34.4 44.2 33.7
18	Milling; storage, and sale of grain, feed, and seed; wholesale grocery; wholesale drug items, and sundries; oil production; trucking; and wholesale paper products. Brother-sister companies are owned by 1 family. Subsidiaries are wholly owned by several brother-sister companies.	Administration is centralized according to common lines of endeavor. Substantially all corporations include the family name in the corporate name. Corporations were formed for each location of each line of products.	5	37	-----	-----	-----	(9)	-----	-----
19	Wholesale, installment, and commercial financing and factoring. Other activities include credit, health, automobile, and life insurance; the manufacture of metal, glass, and plastic products, and heavy machinery; and processing of meat products throughout the United States. Parent is publicly owned. Subsidiaries are wholly owned by parent.	The parent company provides the overall administration. The financing activity is conducted through 1 or more corporations in each State using the same corporate name, followed by the city or State of location. Other corporations were formed to conduct each of the other business activities.	128	-----	-----	-----	-----	(9)	-----	-----

20	Finance business. Publicly owned. Subsidiaries are wholly owned by parent.	Centralized with parent company. Substantially the same officers and directors serve all corporations. Separate companies were formed to conduct the activities in each area. For the most part all companies use the same trade name.	43	763	Present..... New: 22 to 48..... 28 to 48.....	271 218 252	35.5 28.5 33.0	120 142 108	30.7 39.5 30.0
21	Chain of restaurants. Owned by 1 family.	Centralized with 1 company. With minor exceptions, the same officers and directors serve all corporations. Separate corporations were formed to conduct the business in each area.	51	8,111	Present..... New: 22 to 48..... 28 to 48.....	4,045 3,696 3,741	49.9 45.6 46.1	167 191 145	4.0 4.9 3.7
22	Development and lease of real estate in connection with apartment houses and shopping centers. Owned by 1 family.	Centralized with 1 company. Each corporation owns a property unit or complex, except for several "catchall" corporations that are service organizations and also own small miscellaneous parcels.	69	1,361	Present..... New: 22 to 48..... 28 to 48.....	552 470 512	40.6 34.5 37.6	150 177 135	21.4 27.4 20.8
23	Manufacture and retail sale of shoes through more than 1,000 outlets located in approximately 650 cities throughout the United States. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Substantially all of the companies were brought into the business by 1 of the previously merged business entities. As a result, approximately 1/2 of the retail stores are separately incorporated. In addition, there is a separate real estate corporation and more than 100 leasehold corporations. The same officers and directors serve all the companies.	734				(*)		
24	Finance business. The parent company's stock is not widely held. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Generally, each office is separately incorporated. Substantially all companies use the same trade name.	63	4,708	Present..... New: 22 to 48..... 28 to 48.....	2,310 2,096 2,134	49.1 44.5 45.3	133 157 119	5.4 7.9 5.3
25	Distribution and sale of fuel. The parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Substantially all companies use a variation of the parent's name. Subsidiaries were formed according to geographical location of the distribution area. The parent financed the purchase of the subsidiaries' assets through the use of intercompany, open-loan accounts because each subsidiary was formed with a nominal amount of capital.	21	4,235	Present..... New: 22 to 48..... 28 to 48.....	2,099 1,911 1,339	49.6 45.1 45.8	98 295 87	4.5 14.6 4.3
26	Chain of drugstores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. All companies use the same trade name. Separate incorporation is according to geographical location so that stores in 1 area are operated by 1 incorporation.	38	1,314	Present..... New: 22 to 48..... 28 to 48.....	576 504 533	43.8 38.3 40.6	102 121 91	15.0 19.3 14.6

See footnotes at end of table, p. 216.

## Examples of actual multiple incorporation cases—Continued

Case No.	Nature of business and ownership	Administration (management, financial, and legal functions), etc.	Number of corporations		Taxable income <sup>1</sup> (thousands)	Rates <sup>2</sup> (percent)	Computed tax <sup>3</sup> (thousands)	Effective tax rate (percent)	Tax saving from extra surtax exemptions <sup>4</sup> (thousands)	Percentage tax reduction resulting from extra surtax exemptions
			Parent, subsidiary	Brother, sister						
27	Manufacturers and retailers of dry goods. The retail operations are conducted through more than 100 stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Top management decisions are centralized with 1 company. Although 1 of the entities did not separately incorporate its stores prior to the merger, the new stores established are separately incorporated. The constituent companies of each group have the same officers, and insurance coverage is provided to each corporation through blanket policies. All store leases are guaranteed by the parent company. The corporate name of each corporation is the same as the former entity to which it was related.	110	-----	\$4,332	Present..... New: 22 to 48..... 22 to 48.....	\$1,982 1,760 1,834	45.8 40.6 42.3	\$265 313 239	11.8 15.1 11.5
28	Finance business. Parent is closely held. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. With minor exceptions, the same directors and officers serve all companies. The loan activities of each area are separately incorporated. Each company uses the same trade name.	46	-----	852	Present..... New: 22 to 48..... 28 to 48.....	315 259 293	37.0 30.4 34.4	123 144 109	28.1 35.7 27.1
29	Chain of retail stores selling gift items. In excess of 80 percent owned by 1 family.	Centralized with the parent company. With few exceptions each corporation operates a store and uses the same trade name.	35	-----	1,185	Present..... New: to 22 to 48..... 18 to 48.....	\$501 433 404	42.3 36.5 39.2	109 129 98	18.0 23.0 17.4
30	Manufacture and retail sale of shoes. The retail operations are conducted through more than 400 stores located throughout the United States. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. While the parent company operates a number of retail stores, other retail stores are separately incorporated. In addition to the retail corporations, each manufacturing plant is separately incorporated. The same officers and directors serve all companies.	139	-----				( <sup>5</sup> )		
31	Personal loans through approximately 900 offices in 41 States. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Approximately 1/4 of the offices are operated by subsidiary companies which were formed to conduct the operations within certain cities. All companies use the same corporate name, followed by the city of location. With minor exceptions, the same officers and directors serve all the corporations.	345	-----				( <sup>5</sup> )		



32	Chain of food stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company which operates most of the stores. Subsidiaries were formed according to function, such as operate store concessions, other than groceries; buying of produce; distribute products; and to own real estate or leases. With minor exceptions the same officers and directors serve all of the corporations.	38	1,334	Present..... New: 22 to 48... 28 to 48...	556 478 515	41.7 35.8 38.6	132 156 119	19.2 24.6 18.7
33	General-merchandise stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Departments of each store are separately incorporated to merchandise various products. In addition, service corporations were formed to engage in credit in connection with installment accounts, centralized purchasing, etc. The same officers and directors serve all the companies and all corporations use a variation of the same name.	45	2,182	Present..... New: 22 to 48... 28 to 48...	928 804 859	42.5 36.8 39.4	201 237 181	17.8 22.8 17.4
34	Chain of retail shoestores. Approximately 500 stores are located in substantially all States. In addition, manufacturing facilities produce some of the merchandise for the retail stores, as well as merchandise for other distributors. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. For the most part, the separate corporations operate the retail stores located in any 1 city; other corporations were formed to operate each manufacturing facility and each warehouse facility. All the companies use the same name, followed by the city of location. The same officers and directors serve all the corporations.	251				(9)		
35	Taxicab business. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. While most of the corporations operate several taxicabs each, separate corporations were formed to own real estate, operate repair garages, and to provide managerial services. With minor exceptions, the same officers and directors serve all the corporations.	151	457	Present..... New: 22 to 48... 28 to 48...	137 101 128	30.0 22.0 28.0	95 112 85	40.9 52.8 39.9
36	Finance business. Owned by 1 family.	Each office is separately incorporated and each company uses the same trade name. When more than 1 office is located in any 1 city, a numbering system is incorporated in the corporate name.	10	112	Present..... New: 22 to 48... 28 to 48...	35 26 33	31.3 23.4 29.1	18 21 15	34.0 44.6 31.1

See footnotes at end of table, p. 216.

## Examples of actual multiple incorporation cases—Continued

Case No.	Nature of business and ownership	Administration (management, financial, and legal functions), etc.	Number of corporations		Taxable income <sup>1</sup> (thousands)	Rates <sup>2</sup> (percent)	Computed tax <sup>3</sup> (thousands)	Effective tax rate (percent)	Tax saving from extra surtax exemptions <sup>4</sup> (thousands)	Percentage tax reduction resulting from extra surtax exemptions
			Parent, subsidiary	Brother, sister						
37	Chain of general-merchandise stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Separate corporations were formed for each store, as well as several corporations to own real estate and to provide purchasing and warehousing services. The same officers and directors serve all corporations.	67	-----	\$2,443	Present..... New: 22 to 48.... 28 to 48....	\$1,068 928 984	43.7 38.0 40.3	\$207 238 182	16.2 20.4 15.6
38	do.....	Centralized with service companies which do buying, warehousing, distributing, recordkeeping, etc. The parent company arranges for all financing of the entire chain, and acts as guarantor of store leases. The operating corporations were formed to operate generally 2 stores each. In addition, there are a number of real estate corporations. The same officers and directors serve all the corporations which use the same trade name.	157	-----	4,148	Present..... New: 22 to 48.... 28 to 48....	1,628 1,366 1,510	39.2 32.9 36.4	523 618 474	24.3 31.2 23.9
39	Chain of clothing stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company which also guarantees the mortgages payable and long-term leases of the subsidiaries. 1 or more corporations were formed to operate each store, depending upon the variety of merchandise handled. The same officers and directors serve all the companies.	207	-----	2,478	Present..... New: 22 to 48.... 28 to 48....	822 650 775	33.2 26.3 31.3	450 532 408	35.4 45.0 34.5
40	Chain of general-merchandise stores. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	The parent company provides managerial services while a subsidiary was formed to perform the buying, recordkeeping, financial, and legal functions. Generally, each store is separately incorporated and several companies were formed to own real estate and to provide warehousing facilities. With minor exceptions, the same officers and directors serve all the corporations.	72	-----	11,114	Present..... New: 22 to 48.... 28 to 48....	5,491 4,994 5,073	49.4 44.9 45.6	283 334 256	4.9 6.3 4.8

41	Personal loans, automobile financing, and various types of insurance. Finance and personal loan offices are located in 15 States. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with the parent company. Each finance and loan office is separately incorporated, as well as each line of insurance. For the most part, the finance and loan companies use the same name, followed by the city of location.	290				(9)			
42	Sale of cigarettes, food, and related items through vending machines. In addition, some of the vending products are manufactured and programed music is provided on a contract basis. Parent is publicly owned. Subsidiaries are wholly owned by parent.	Centralized with the parent company. A number of corporations were formed for each activity principally on the basis of geographical location.	56				(9)			
43	Clothing concessions in shopping centers. Owned by 2 related stockholders.	The management functions, including purchasing, payroll, and accounting, are performed by a management company. Other corporations were formed for each retail outlet.	16	420	Present.....	143	34.0	70	32.9	
					New:					
					22 to 48....	113	26.8	62	42.2	
					28 to 48....	133	31.7	62	31.7	
44	Food brokerage. Brother-sister companies, which own subsidiaries, are closely owned.	Centralized in 1 office. Several companies engage in food brokerage while other companies were formed to provide warehouse facilities. Same officers and directors serve all companies.	7	2	129	Present.....	49	38.0	12	19.7
					New:					
					22 to 48....	43	33.3	13	23.8	
					28 to 48....	46	35.6	10	17.1	
45	Sale of paint products. Parent is publicly owned. Subsidiaries are wholly owned by parent.	Centralized with parent company. Same officers and directors serve all companies. All companies use same trade name. Each store is separately incorporated.	20	293	Present.....	94	32.1	53	38.0	
					New:					
					22 to 48....	71	24.3	63	46.9	
					28 to 48....	87	29.8	47	35.0	
46	Buying and developing unimproved real estate as well as building and selling residential houses. Owned by husband and wife.	Centralized in 1 management corporation. Construction companies are separately incorporated by geographic location. Other corporations were formed to perform management or sales functions.	10	356	Present.....	130	36.5	49	27.4	
					New:					
					22 to 48....	106	29.8	58	35.5	
					28 to 48....	121	34.0	43	26.3	
47	Sale of new and used cars in 3 locations, as well as auto financing and insurance, auto repairs, car and truck rental, and real estate rental. Owned by 1 individual.	Books and records maintained at the 3 retail locations. Other administrative functions are centralized. Separate corporations exist in each location to engage in sale of cars and trucks. Certain locations have separate corporations to engage in body repair, financing, auto and truck leasing, and real estate rental.	10	307	Present.....	117	38.1	37	24.0	
					New:					
					22 to 48....	67	21.7	74	52.7	
					28 to 48....	109	35.4	32	22.9	

See footnotes at end of table, p. 216.

## Examples of actual multiple incorporation cases—Continued

Case No.	Nature of business and ownership	Administration (management, financial, and legal functions), etc.	Number of corporations		Taxable income <sup>1</sup> (thousands)	Rates <sup>2</sup> (percent)	Computed tax <sup>3</sup> (thousands)	Effective tax rate (percent)	Tax saving from extra surtax exemptions <sup>4</sup> (thousands)	Percentage tax reduction resulting from extra surtax exemptions
			Parent, subsidiary	Brother, sister						
48	Operation of a chain of 510 stores in 10 States. In addition, operations include feeder plants to produce many food products. Parent is publicly owned. Subsidiaries are wholly owned by the parent.	Centralized with parent corporation. Substantially the same directors serve all companies. Retail corporations were formed to control certain geographic areas. Other corporations were formed to distribute the manufactured products and to provide warehouse facilities and advertising services.	56	-----	-----	-----	-----	(5)	-----	-----

<sup>1</sup> Without regard to losses of constituent companies.

<sup>2</sup> Present rates refer to the 30-percent normal tax and the 22-percent surtax contained in existing law. The 22-48-percent rate refers to the 22-percent normal tax and 26-percent surtax which will be applicable to all corporations not electing multiple surtax exemptions beginning in 1965. The 22-48-percent rate refers to the tax applicable to members of a controlled group electing to retain multiple exemptions. A 6-percent additional tax applies to the 1st \$25,000 of income. Therefore, the rate is 28 percent on the first \$25,000 of income, and 48 percent on the excess.

<sup>3</sup> Computation based upon applying applicable tax rates to the income of constituent profitable companies, without regard to losses of constituent loss companies.

<sup>4</sup> In many instances, if the affiliated group had operated as a single corporation or filed a consolidated return, the tax liability would not have been increased by the full amount of the tax savings from multiple surtax exemptions because of compensating tax advantages from the offsetting of gains and losses of constituent companies, etc.

<sup>5</sup> See supplement.

Supplement: Examples of actual multiple-incorporation cases <sup>1</sup>

Taxable income <sup>2</sup> (thousands)	Present tax rate structure				New rates <sup>3</sup>							
	Tax liability (com- puted) <sup>4</sup> (thou- sands)	Effective tax rate (percent)	Tax saving from extra surtax exemp- tions (thou- sands)	Percent of tax reduc- tion result- ing from extra surtax exemp- tions	Tax liability (computed) <sup>4</sup> (thousands)		Effective tax rate (percent)		Tax saving from extra surtax exemptions (thousands)		Percentage tax reduction resulting from extra surtax exemp- tions	
					22 to 48 percent	28 to 48 percent	22 to 48 percent	28 to 48 percent	22 to 48 percent	28 to 48 percent	22 to 48 percent	28 to 48 percent
\$4,924	\$1,981	40.2	\$574	22.5	\$1,679	\$1,837	34.1	37.3	\$678	\$520	28.8	22.1
\$1,936	581	30.0	421	42.0	426	542	22.0	28.0	497	381	53.9	41.3
\$3,221	1,443	44.8	227	13.6	1,272	1,335	39.5	41.4	268	205	11.4	13.3
\$11,887	5,172	43.5	1,102	17.6	4,397	4,699	37.0	39.5	1,309	1,007	22.9	17.6
\$14,478	7,281	50.3	242	3.2	6,657	6,724	46.0	46.4	285	217	4.1	3.1
\$33,217	17,011	51.2	257	1.5	15,634	15,705	47.1	47.3	303	231	1.9	1.4
\$58,067	29,692	51.1	497	1.6	27,273	27,415	47.0	47.2	588	451	2.1	1.6
\$2,730	1,218	44.6	197	13.9	1,621	1,678	41.7	43.1	239	182	12.8	9.8
\$5,919	2,484	42.0	588	19.1	2,140	2,302	38.1	38.9	695	533	24.5	18.8
\$18,143	8,422	46.4	1,007	10.7	7,512	7,788	41.4	42.9	1,190	914	13.7	10.5
\$6,852	3,133	48.9	430	11.9	2,779	2,898	40.6	42.3	504	385	15.3	11.7
\$27,531	13,675	49.7	636	4.4	12,436	12,613	45.2	45.9	751	577	5.7	4.4

<sup>1</sup> Without regard to losses of constituent companies.

<sup>2</sup> Present rates refer to the 30 percent normal tax and the 22 percent surtax contained in existing law. The 22 to 48 percent rate refers to the 22 percent normal tax and 26 percent surtax which will be applicable to all corporations not electing multiple-surtax exemptions beginning in 1965. The 28 to 48 percent rate refers to the tax applicable to members of a controlled group electing to retain multiple exemptions. A 6 percent additional tax applies to the first \$25,000 of income. Therefore, the rate is 28 percent on the first \$25,000 of income, and 48 percent on the excess.

<sup>3</sup> Computation based upon applying applicable tax rates to the income of constituent profitable companies, without regard to losses of constituent loss companies.

<sup>4</sup> In many instances, if the affiliated group had operated as a single corporation or filed a consolidated return, the tax liability would not have been increased by the full amount of the tax savings from multiple-surtax exemptions because of compensating tax advantages from the offsetting of gains and losses of constituent companies, etc.

PART II. THE HOUSE BILL—ITS OPERATION AND EFFECT

Under the House bill there are essentially three alternative methods of taxation available to a controlled group of corporations. These alternatives are:

(1) The group could file a consolidated return, in which case it would be limited to a single surtax exemption and would be subject to a 22-percent tax on the first \$25,000 of income and a 48-percent tax on the excess. The additional 2-percent penalty tax levied under existing law has been eliminated under the bill. (2) The group could file on a separate basis, but receive only a single surtax exemption to be divided among the members of the group. The rate for each corporation would be 22 percent on the income up to its portion of the surtax exemption, and 48 percent on the excess; or (3) the group could file on a separate basis as in (2), but could elect to retain multiple surtax exemptions. Under such an election, each corporation pays a 28-percent tax on income on the first \$25,000 (22 percent, plus a 6 percent additional tax) and 48 percent on the excess.

Thus, for example, assume that all three members of a controlled group of corporations each earn \$40,000 in 1965. If the group elects to retain multiple surtax exemptions, each corporation will pay a tax of \$14,200 (28 percent times \$25,000, plus 48 percent times \$15,000), or a total tax of \$42,600. If the group does not elect multiple exemptions and files on a separate return basis, only a single surtax exemption is available to the group. The exemption may be apportioned on a pro rata basis, or in any other manner the group deems proper. Assuming the exemption is split up on a pro rata basis (\$8,333 each), each corporation will pay a tax of \$17,033, or a total tax of \$51,100. Presumably, the group would elect to retain multiple surtax exemptions in this case. If, however, each corporation earned only \$5,000, the group would presumably not elect multiple exemptions since the rate of tax would be 22 percent instead of 28 percent.

The additional tax is by no means a deterrent to the use of multiple structures. Those who have heretofore enjoyed tax savings through multiple incorporation, will continue to do so. However, the additional tax does serve a vital function. It prevents a controlled group from reaping the benefits of the 22-percent tax on the initial \$25,000 of income—a rate which is designed solely for the aid of small business. Without a safeguard, a 22-percent rate would not be possible, to the ultimate detriment of the small business community.

Even if the additional tax is paid, multiple corporations will still receive a substantial tax cut. The rate on the first \$25,000 drops from 30 to 28 percent, and income in excess of \$25,000 is taxed at a 48-percent rate in lieu of the present 52-percent rate. However, due to the additional 6-percent tax, the tax reduction for the proliferated multicorporate group is less relative to that of firms which are in fact small and independently operated. An independent small business earning less than \$25,000 will receive a 26.7-percent reduction in tax liability. On the other hand, a corporate unit in a large chain, in which each constituent corporation earns \$25,000 or less, will receive a 6.7-percent reduction. Other similar comparisons are as follows:

Income per corporation	Percentage reduction	
	Corporation, independently owned, using 1 surtax exemption	Member of a controlled group electing to retain multiple surtax exemptions
\$50,000.....	14.6	7.3
\$100,000.....	10.8	7.5
\$200,000.....	9.1	7.6
\$500,000.....	8.3	7.7

A large chain earning \$1 million which is presently filing a consolidated return would receive an 11.4 percent reduction in tax liability. The liability of a large firm earning \$1 million and operating out of divisions will be reduced about 8 percent. Both of these figures compare favorably to the 7.7 percent reduction which would be available to each member of a controlled group of corporations electing to retain multiple exemptions and earning a similar amount.

The effect of the proposed changes on controlled groups of corporations can also be seen in this exhibit. The tax liability, tax rates, and tax savings from multiple surtax exemption at the present are indicated in the first line on the right-hand side of each entry. The extent to which this abuse would be magnified by rate reduction without the additional tax is indicated in the second line.

The third line indicates the extent to which the abuse is limited as the result of applying the 6 percent additional tax to the first \$25,000 taxable income of each constituent corporation. While there is still a significant tax advantage available to a controlled group of corporations filing separate returns, the advantage is significantly reduced below what it would be in the absence of the additional tax. Moreover, since each extra surtax exemption will be worth \$5,000 to the group (20 percent times \$25,000) in lieu of \$5,500 (as under existing law), the amount of the tax advantage available to controlled groups will be less than it is under existing law.

## EXHIBIT 14

## TAX BURDEN TABLES, RATES SCHEDULES, ETC.

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## Comparison of tax liabilities, present law, and House bill in 1965:

Table 1. Single taxpayer with standard deduction.

Table 2. Married couple with no dependents with standard deduction.

Table 3. Married couple with two dependents with standard deduction.

Table 4. Married couple with two dependents with typical average itemized deductions.

## Present law tax rate schedules for 1963:

Table 5. Single taxpayers and married taxpayers filing separate returns.

Table 6. Married taxpayers filing joint returns.

## House bill tax rate schedules for 1964:

Table 7. Single taxpayers and married persons filing separate returns.

Table 8. Married taxpayers filing joint returns.

## House bill tax rate schedules for 1965:

Table 9. Single taxpayers and married persons filing separate returns.

Table 10. Married taxpayers filing joint returns.

## Miscellaneous tables:

Table 11. Distribution by adjusted gross income classes of tax changes in House bill (excluding capital gains).

Table 12. Distribution of taxable income and tax by taxable income brackets, 1963.

TABLE 1.—Comparison of tax liabilities, present law and House bill in 1965—  
Single taxpayer, with standard deduction

Income (wages and salaries)	Tax		Tax cut	Percent tax cut	Tax as percent of income	
	Present law	House bill			Present law	House bill
\$1,000.....	\$60	\$14	\$46	77	6	1
\$1,500.....	150	85	65	43	10	6
\$2,000.....	240	161	79	33	12	8
\$3,000.....	422	329	93	22	14	11
\$4,000.....	620	500	120	19	16	13
\$5,000.....	818	671	147	18	16	13
\$6,000.....	1,048	866	182	17	18.	14
\$7,500.....	1,405	1,168	237	17	19	16
\$10,000.....	2,096	1,742	354	17	21	17
\$12,500.....	2,982	2,478	504	17	24	20
\$15,000.....	4,002	3,334	668	17	27	22
\$17,500.....	5,163	4,291	872	17	29	25
\$20,000.....	6,412	5,350	1,062	17	32	27

NOTE.—House bill tax liability reflects use of the minimum standard deduction where applicable.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 1, 1963.

TABLE 2.—Comparison of tax liabilities, present law and House bill in 1965—  
Married couple with no dependents, with standard deduction

Income (wages and salaries)	Tax		Tax cut	Percent tax cut	Tax as percent of income	
	Present law	House bill			Present law	House bill
\$1,000.....	0	0	0	0	0	0
\$1,500.....	\$30	0	\$30	100	2	0
\$2,000.....	120	\$56	64	53	6	3
\$3,000.....	300	200	100	33	10	7
\$4,000.....	480	354	126	26	12	9
\$5,000.....	660	501	159	24	13	10
\$6,000.....	844	658	186	22	14	11
\$7,500.....	1,141	915	226	20	15	12
\$10,000.....	1,636	1,342	294	18	16	13
\$12,500.....	2,278	1,886	392	17	18	15
\$15,000.....	2,960	2,460	500	17	20	16
\$17,500.....	3,710	3,085	625	17	21	18
\$20,000.....	4,532	3,764	768	17	23	19

NOTE.—House bill tax liability reflects use of the minimum standard deduction where applicable.

TABLE 3.—Comparison of tax liabilities, present law and House bill in 1965—  
Married couple with 2 dependents, with standard deduction

Income (wages and salaries)	Tax		Tax cut	Percent tax cut	Tax as percent of income	
	Present law	House bill			Present law	House bill
\$1,000.....	0	0			0	0
\$1,500.....	0	0			0	0
\$2,000.....	0	0			0	0
\$3,000.....	\$60	0	\$60	100	2	0
\$4,000.....	240	\$140	100	42	6	4
\$5,000.....	420	290	130	31	8	6
\$6,000.....	600	450	150	25	10	8
\$7,500.....	877	686	191	22	12	9
\$10,000.....	1,372	1,114	258	19	14	11
\$12,500.....	1,966	1,622	344	17	16	13
\$15,000.....	2,616	2,172	444	17	17	15
\$17,500.....	3,350	2,785	565	17	19	16
\$20,000.....	4,124	3,428	696	17	21	17

NOTE.—House bill tax liability reflects use of the minimum standard deduction where applicable.

TABLE 4.—Comparison of tax liabilities, present law and House bill in 1965—  
Married couple with 2 dependents, with typical average itemized deductions

Income (wages and salaries)	Tax		Tax cut	Percent tax cut	Tax as percent of income	
	Present law	House bill			Present law	House bill
\$5,000.....	\$300	\$223	\$77	26	6	5
\$6,000.....	456	343	113	25	8	6
\$7,500.....	720	576	144	20	10	8
\$10,000.....	1,196	994	202	17	12	10
\$12,500.....	1,684	1,400	284	16	13	11
\$15,000.....	2,213	1,865	348	16	15	12
\$17,500.....	2,772	2,343	429	16	16	13
\$20,000.....	3,410	2,876	535	16	17	14
\$25,000.....	4,821	4,063	758	16	19	16
\$30,000.....	6,429	5,416	1,014	16	21	18
\$40,000.....	10,188	8,505	1,683	16	26	22
\$50,000.....	14,676	12,869	2,207	15	29	25
\$75,000.....	24,952	21,390	3,563	14	33	29
\$100,000.....	36,720	31,442	5,278	14	37	31

NOTE.—House bill tax liability reflects use of the minimum standard deduction (where applicable) and the disallowance of certain State and local excise taxes as deductions.



TABLE 5.—Present law: Tax rate schedule for calendar year 1963

## SCHEDULE I. SINGLE TAXPAYERS AND MARRIED PERSONS FILING SEPARATE RETURNS

If taxable income is—		Then the tax is—	
Not over \$2,000.....		20 percent of taxable income.	
Over—	But not over—		Of excess over—
\$2,000.....	\$4,000.....	\$400, plus 22 percent.....	\$2,000
\$4,000.....	\$6,000.....	\$840, plus 26 percent.....	\$4,000
\$6,000.....	\$8,000.....	\$1,360, plus 30 percent.....	\$6,000
\$8,000.....	\$10,000.....	\$1,960, plus 34 percent.....	\$8,000
\$10,000.....	\$12,000.....	\$2,640, plus 38 percent.....	\$10,000
\$12,000.....	\$14,000.....	\$3,400, plus 43 percent.....	\$12,000
\$14,000.....	\$16,000.....	\$4,260, plus 47 percent.....	\$14,000
\$16,000.....	\$18,000.....	\$5,200, plus 50 percent.....	\$16,000
\$18,000.....	\$20,000.....	\$6,200, plus 53 percent.....	\$18,000
\$20,000.....	\$22,000.....	\$7,260, plus 56 percent.....	\$20,000
\$22,000.....	\$26,000.....	\$8,380, plus 59 percent.....	\$22,000
\$26,000.....	\$32,000.....	\$10,740, plus 62 percent.....	\$26,000
\$32,000.....	\$38,000.....	\$14,460, plus 65 percent.....	\$32,000
\$38,000.....	\$44,000.....	\$18,360, plus 69 percent.....	\$38,000
\$44,000.....	\$50,000.....	\$22,500, plus 72 percent.....	\$44,000
\$50,000.....	\$60,000.....	\$26,820, plus 75 percent.....	\$50,000
\$60,000.....	\$70,000.....	\$34,320, plus 78 percent.....	\$60,000
\$70,000.....	\$80,000.....	\$42,120, plus 81 percent.....	\$70,000
\$80,000.....	\$90,000.....	\$50,220, plus 84 percent.....	\$80,000
\$90,000.....	\$100,000.....	\$58,620, plus 87 percent.....	\$90,000
\$100,000.....	\$150,000.....	\$67,320, plus 89 percent.....	\$100,000
\$150,000.....	\$200,000.....	\$111,820, plus 90 percent.....	\$150,000
\$200,000 and over.....		\$156,820, plus 91 percent.....	\$200,000

TABLE 6.—Present law: Tax rate schedule for calendar year 1963

## SCHEDULE II. MARRIED TAXPAYERS FILING JOINT RETURNS

If taxable income is—		Then the tax is—	
Not over \$4,000.....		20 percent of taxable income.	
Over—	But not over—		Of excess over—
\$4,000.....	\$8,000.....	\$800, plus 22 percent.....	\$4,000
\$8,000.....	\$12,000.....	\$1,680, plus 26 percent.....	\$8,000
\$12,000.....	\$16,000.....	\$2,720, plus 30 percent.....	\$12,000
\$16,000.....	\$20,000.....	\$3,920, plus 34 percent.....	\$16,000
\$20,000.....	\$24,000.....	\$5,280, plus 38 percent.....	\$20,000
\$24,000.....	\$28,000.....	\$6,800, plus 43 percent.....	\$24,000
\$28,000.....	\$32,000.....	\$8,520, plus 47 percent.....	\$28,000
\$32,000.....	\$36,000.....	\$10,400, plus 50 percent.....	\$32,000
\$36,000.....	\$40,000.....	\$12,400, plus 53 percent.....	\$36,000
\$40,000.....	\$44,000.....	\$14,520, plus 56 percent.....	\$40,000
\$44,000.....	\$52,000.....	\$16,760, plus 59 percent.....	\$44,000
\$52,000.....	\$64,000.....	\$21,480, plus 62 percent.....	\$52,000
\$64,000.....	\$76,000.....	\$28,920, plus 65 percent.....	\$64,000
\$76,000.....	\$88,000.....	\$36,720, plus 69 percent.....	\$76,000
\$88,000.....	\$100,000.....	\$45,000, plus 72 percent.....	\$88,000
\$100,000.....	\$120,000.....	\$53,640, plus 75 percent.....	\$100,000
\$120,000.....	\$140,000.....	\$68,640, plus 78 percent.....	\$120,000
\$140,000.....	\$160,000.....	\$84,240, plus 81 percent.....	\$140,000
\$160,000.....	\$180,000.....	\$100,440, plus 84 percent.....	\$160,000
\$180,000.....	\$200,000.....	\$117,240, plus 87 percent.....	\$180,000
\$200,000.....	\$300,000.....	\$134,640, plus 89 percent.....	\$200,000
\$300,000.....	\$400,000.....	\$223,640, plus 90 percent.....	\$300,000
\$400,000 and over.....		\$313,640, plus 91 percent.....	\$400,000

TABLE 7.—Revenue bill of 1963: Tax rate schedule for calendar year 1964

## SCHEDULE I. SINGLE TAXPAYERS AND MARRIED PERSONS FILING SEPARATE RETURNS

If taxable income is—		Then the tax is—	
Not over \$500.....		16 percent of taxable income.	
Over—	But not over—		Of excess over—
\$500.....	\$1,000.....	\$80, plus 16.5 percent.....	\$500
\$1,000.....	\$1,500.....	\$162.5, plus 17.5 percent.....	\$1,000
\$1,500.....	\$2,000.....	\$250, plus 18 percent.....	\$1,500
\$2,000.....	\$4,000.....	\$340, plus 20 percent.....	\$2,000
\$4,000.....	\$6,000.....	\$740, plus 23.5 percent.....	\$4,000
\$6,000.....	\$8,000.....	\$1,210, plus 27 percent.....	\$6,000
\$8,000.....	\$10,000.....	\$1,750, plus 30.5 percent.....	\$8,000
\$10,000.....	\$12,000.....	\$2,360, plus 34 percent.....	\$10,000
\$12,000.....	\$14,000.....	\$3,040, plus 37.5 percent.....	\$12,000
\$14,000.....	\$16,000.....	\$3,790, plus 41 percent.....	\$14,000
\$16,000.....	\$18,000.....	\$4,610, plus 44.5 percent.....	\$16,000
\$18,000.....	\$20,000.....	\$5,500, plus 47.5 percent.....	\$18,000
\$20,000.....	\$22,000.....	\$6,450, plus 50.5 percent.....	\$20,000
\$22,000.....	\$26,000.....	\$7,460, plus 53.5 percent.....	\$22,000
\$26,000.....	\$32,000.....	\$9,600, plus 56 percent.....	\$26,000
\$32,000.....	\$38,000.....	\$12,060, plus 58.5 percent.....	\$32,000
\$38,000.....	\$44,000.....	\$16,470, plus 61 percent.....	\$38,000
\$44,000.....	\$50,000.....	\$20,130, plus 63.5 percent.....	\$44,000
\$50,000.....	\$60,000.....	\$23,040, plus 66 percent.....	\$50,000
\$60,000.....	\$70,000.....	\$30,540, plus 68.5 percent.....	\$60,000
\$70,000.....	\$80,000.....	\$37,390, plus 71 percent.....	\$70,000
\$80,000.....	\$90,000.....	\$44,490, plus 73.5 percent.....	\$80,000
\$90,000.....	\$100,000.....	\$51,840, plus 75 percent.....	\$90,000
\$100,000.....	\$150,000.....	\$59,340, plus 76.5 percent.....	\$100,000
\$150,000.....	\$200,000.....	\$97,690, plus 76.5 percent.....	\$150,000
\$200,000 and over.....		\$135,840, plus 77 percent.....	\$200,000

TABLE 8.—Revenue bill of 1963: Tax rate schedule for calendar year 1964

## SCHEDULE II. MARRIED TAXPAYERS FILING JOINT RETURNS

If taxable income is—		Then the tax is—	
Not over \$1,000.....		16 percent of taxable income.	
Over—	But not over—		Of excess over—
\$1,000.....	\$2,000.....	\$160, plus 16.5 percent.....	\$1,000
\$2,000.....	\$3,000.....	\$325, plus 17.5 percent.....	\$2,000
\$3,000.....	\$4,000.....	\$500, plus 18 percent.....	\$3,000
\$4,000.....	\$8,000.....	\$680, plus 20 percent.....	\$4,000
\$8,000.....	\$12,000.....	\$1,480, plus 23.5 percent.....	\$8,000
\$12,000.....	\$16,000.....	\$2,420, plus 27 percent.....	\$12,000
\$16,000.....	\$20,000.....	\$3,500, plus 30.5 percent.....	\$16,000
\$20,000.....	\$24,000.....	\$4,720, plus 34 percent.....	\$20,000
\$24,000.....	\$28,000.....	\$6,080, plus 37.5 percent.....	\$24,000
\$28,000.....	\$32,000.....	\$7,580, plus 41 percent.....	\$28,000
\$32,000.....	\$36,000.....	\$9,220, plus 44.5 percent.....	\$32,000
\$36,000.....	\$40,000.....	\$11,000, plus 47.5 percent.....	\$36,000
\$40,000.....	\$44,000.....	\$12,900, plus 50.5 percent.....	\$40,000
\$44,000.....	\$52,000.....	\$14,920, plus 53.5 percent.....	\$44,000
\$52,000.....	\$64,000.....	\$19,200, plus 56 percent.....	\$52,000
\$64,000.....	\$76,000.....	\$25,920, plus 58.5 percent.....	\$64,000
\$76,000.....	\$88,000.....	\$32,040, plus 61 percent.....	\$76,000
\$88,000.....	\$100,000.....	\$40,260, plus 63.5 percent.....	\$88,000
\$100,000.....	\$120,000.....	\$47,880, plus 66 percent.....	\$100,000
\$120,000.....	\$140,000.....	\$61,080, plus 68.5 percent.....	\$120,000
\$140,000.....	\$160,000.....	\$74,780, plus 71 percent.....	\$140,000
\$160,000.....	\$180,000.....	\$88,980, plus 73.5 percent.....	\$160,000
\$180,000.....	\$200,000.....	\$103,680, plus 75 percent.....	\$180,000
\$200,000.....	\$300,000.....	\$118,680, plus 76.5 percent.....	\$200,000
\$300,000.....	\$400,000.....	\$195,180, plus 76.5 percent.....	\$300,000
\$400,000 and over.....		\$271,680, plus 77 percent.....	\$400,000

TABLE 9.—Revenue bill of 1963: Tax rate schedule for calendar year 1965

## SCHEDULE I. SINGLE TAXPAYERS AND MARRIED PERSONS FILING SEPARATE RETURNS

If taxable income is—		Then the tax is—	
Not over \$500.....		14 percent of taxable income.	
Over—	But not over—		Of excess over—
\$500.....	\$1,000.....	\$70, plus 15 percent.....	\$500
\$1,000.....	\$1,500.....	\$145, plus 16 percent.....	\$1,000
\$1,500.....	\$2,000.....	\$225, plus 17 percent.....	\$1,500
\$2,000.....	\$4,000.....	\$310, plus 19 percent.....	\$2,000
\$4,000.....	\$6,000.....	\$690, plus 22 percent.....	\$4,000
\$6,000.....	\$8,000.....	\$1,130, plus 25 percent.....	\$6,000
\$8,000.....	\$10,000.....	\$1,630, plus 28 percent.....	\$8,000
\$10,000.....	\$12,000.....	\$2,190, plus 32 percent.....	\$10,000
\$12,000.....	\$14,000.....	\$2,830, plus 36 percent.....	\$12,000
\$14,000.....	\$16,000.....	\$3,550, plus 39 percent.....	\$14,000
\$16,000.....	\$18,000.....	\$4,330, plus 42 percent.....	\$16,000
\$18,000.....	\$20,000.....	\$5,170, plus 45 percent.....	\$18,000
\$20,000.....	\$22,000.....	\$6,070, plus 48 percent.....	\$20,000
\$22,000.....	\$26,000.....	\$7,080, plus 50 percent.....	\$22,000
\$26,000.....	\$32,000.....	\$9,030, plus 53 percent.....	\$26,000
\$32,000.....	\$38,000.....	\$12,210, plus 55 percent.....	\$32,000
\$38,000.....	\$44,000.....	\$15,510, plus 58 percent.....	\$38,000
\$44,000.....	\$60,000.....	\$18,990, plus 60 percent.....	\$44,000
\$60,000.....	\$80,000.....	\$22,590, plus 62 percent.....	\$60,000
\$80,000.....	\$100,000.....	\$28,790, plus 64 percent.....	\$80,000
\$100,000.....	\$150,000.....	\$35,190, plus 66 percent.....	\$100,000
\$150,000.....	\$200,000.....	\$41,790, plus 68 percent.....	\$150,000
\$200,000 and over.....		\$48,590, plus 69 percent.....	\$200,000
		\$55,490, plus 70 percent.....	\$100,000
		\$90,490, plus 70 percent.....	\$150,000
		\$125,490, plus 70 percent.....	\$200,000

TABLE 10.—Revenue bill of 1963: Tax rate schedule for calendar year 1965

## SCHEDULE II. MARRIED TAXPAYERS FILING JOINT RETURNS

If taxable income is—		Then the tax is—	
Not over \$1,000.....		14 percent of taxable income.	
Over—	But not over—		Of excess over
\$1,000.....	\$2,000.....	\$140, plus 15 percent.....	\$1,000
\$2,000.....	\$3,000.....	\$290, plus 16 percent.....	\$2,000
\$3,000.....	\$4,000.....	\$450, plus 17 percent.....	\$3,000
\$4,000.....	\$8,000.....	\$620, plus 19 percent.....	\$4,000
\$8,000.....	\$12,000.....	\$1,380, plus 22 percent.....	\$8,000
\$12,000.....	\$16,000.....	\$2,290, plus 25 percent.....	\$12,000
\$16,000.....	\$20,000.....	\$3,290, plus 28 percent.....	\$16,000
\$20,000.....	\$24,000.....	\$4,380, plus 32 percent.....	\$20,000
\$24,000.....	\$28,000.....	\$5,660, plus 36 percent.....	\$24,000
\$28,000.....	\$32,000.....	\$7,100, plus 39 percent.....	\$28,000
\$32,000.....	\$36,000.....	\$8,660, plus 42 percent.....	\$32,000
\$36,000.....	\$40,000.....	\$10,340, plus 45 percent.....	\$36,000
\$40,000.....	\$44,000.....	\$12,140, plus 48 percent.....	\$40,000
\$44,000.....	\$52,000.....	\$14,060, plus 50 percent.....	\$44,000
\$52,000.....	\$64,000.....	\$18,060, plus 53 percent.....	\$52,000
\$64,000.....	\$76,000.....	\$24,420, plus 55 percent.....	\$64,000
\$76,000.....	\$88,000.....	\$31,020, plus 58 percent.....	\$76,000
\$88,000.....	\$100,000.....	\$37,980, plus 60 percent.....	\$88,000
\$100,000.....	\$120,000.....	\$45,180, plus 62 percent.....	\$100,000
\$120,000.....	\$140,000.....	\$57,680, plus 64 percent.....	\$120,000
\$140,000.....	\$160,000.....	\$70,380, plus 66 percent.....	\$140,000
\$160,000.....	\$180,000.....	\$83,680, plus 68 percent.....	\$160,000
\$180,000.....	\$200,000.....	\$97,180, plus 69 percent.....	\$180,000
\$200,000.....	\$300,000.....	\$110,980, plus 70 percent.....	\$200,000
\$300,000.....	\$400,000.....	\$180,980, plus 70 percent.....	\$300,000
\$400,000 and over.....		\$250,980, plus 70 percent.....	\$400,000

TABLE 11.—Revenue bill of 1963: Individual income tax—Distribution by adjusted gross income classes of proposed tax changes excluding capital gains

Adjusted gross income class (thousands of dollars)	Number of taxable returns (millions)	Adjusted gross income	Present law tax	Tax change under bill	Tax under bill	Present law tax as a percent of adjusted gross income	Tax under bill as a percent of adjusted gross income
Amounts in millions of dollars							
0 to \$3.....	9.7	18,280	1,450	—555	895	7.9	4.9
\$3 to \$5.....	10.5	42,930	4,030	—1,055	2,975	9.4	6.9
\$5 to \$10.....	27.9	163,050	18,300	—3,650	14,650	11.2	9.0
\$10 to \$20.....	6.7	84,540	12,710	—2,090	10,620	15.0	12.6
\$20 to \$50.....	1.0	29,720	6,760	—1,020	5,740	22.7	19.3
\$50 and over.....	.2	11,800	4,170	—525	3,645	35.3	30.9
Total.....	51.0	350,320	47,420	—8,895	38,525	13.5	11.0
Percent distribution by income classes							
0 to \$3.....	19.0	5.2	3.1	6.2	2.3		
\$3 to \$5.....	20.6	12.3	8.5	11.9	7.7		
\$5 to \$10.....	44.9	46.5	38.6	41.0	38.0		
\$10 to \$20.....	13.1	24.1	26.8	23.5	27.6		
\$20 to \$50.....	2.0	8.5	14.3	11.5	14.9		
\$50 and over.....	.4	3.4	8.8	5.9	9.5		
Total.....	100.0	100.0	100.0	100.0	100.0		

NOTE.—Amounts of adjusted gross income, tax and tax changes exclude capital gains taxed at the alternative rate. Figures are rounded and will not necessarily add to totals.

TABLE 12.—Distribution of taxable income and tax by taxable income brackets, 1963<sup>1 2</sup>

[In millions of dollars]

Taxable income class (in thousands of dollars)	Taxable income <sup>1</sup>	Present law tax <sup>2</sup>	Cumulative			
			Taxable income		Present law tax	
			From top bracket	From bottom bracket	From top bracket	From bottom bracket
0 to 1.....	76,690	15,338	207,123	76,690	47,933	15,338
1 to 2.....	62,658	10,532	130,433	129,348	32,595	25,870
2 to 4.....	42,226	9,290	77,775	171,574	22,063	35,160
4 to 6.....	13,216	3,436	35,549	184,790	12,773	38,596
6 to 8.....	6,941	2,082	22,333	191,731	9,337	40,678
8 to 10.....	3,916	1,331	15,392	195,647	7,255	42,009
10 to 12.....	2,641	966	11,470	198,188	5,924	42,975
12 to 14.....	1,866	802	8,835	200,054	4,958	43,777
14 to 16.....	1,436	675	7,069	201,490	4,156	44,452
16 to 18.....	1,109	555	5,633	202,599	3,481	45,007
18 to 20.....	727	385	4,624	203,326	2,926	45,362
20 to 22.....	517	290	3,707	203,843	2,541	45,682
22 to 26.....	761	449	3,280	204,604	2,251	46,131
26 to 32.....	740	459	2,519	205,344	1,802	46,500
32 to 38.....	423	275	1,779	205,767	1,343	46,865
38 to 44.....	265	183	1,356	206,032	1,068	47,048
44 to 50.....	195	140	1,091	206,227	885	47,188
50 to 60.....	213	160	896	206,440	745	47,348
60 to 70.....	130	101	683	206,570	585	47,449
70 to 80.....	96	78	553	206,666	484	47,527
80 to 90.....	68	57	457	206,734	406	47,584
90 to 100.....	46	40	389	206,780	349	47,624
100 to 150.....	136	121	343	206,916	309	47,745
150 to 200.....	58	52	207	206,974	188	47,797
200 and over.....	149	136	149	207,123	136	47,933
Total.....	207,123	47,933				

<sup>1</sup> Excludes \$2.4 billion of long-term gains subject to the alternative rate.

<sup>2</sup> Tax before credits of \$0.5 billion and alternative tax on capital gains of \$1.2 billion.

The CHAIRMAN. Thank you very much, Mr. Secretary.

Mr. Secretary, I think you will recall that before the session began, I think in December, you and my friend, Henry Fowler, came up to my Virginia home and explained your plan whereby you would reduce taxes without reduction in expenditures.

I said to you then that I had been in the Senate for around 30 years and I have seen many promises made to reduce expenditures. But practically none has been carried out. I told you that I was conscientiously opposed to any tax reduction that is not accompanied by a reduction in expenditures.

That was in December and the budget was submitted in January. As I recall, there was an expenditure increase of about \$4 billion over the previous fiscal year?

Secretary DILLON. Yes, it is.

The CHAIRMAN. So I want to say this:

It seems to me, Mr. Secretary, a serious aspect of this legislation is the fact that tremendous propaganda is being used to make people think these tax proposals would cure all of our ills, and that the panacea for everything is to reduce taxes on borrowed money. This would abolish unemployment, we are told, or greatly reduce unemployment. It would stop the outflow of gold and it would do everything else that should be done. I believe very serious thought should be given to this departure for the first time in the history of this country. From all the information I could get, no President has advocated a deliberately planned deficit by reducing taxes and increasing expenditures at the same time.

Am I correct in that?

Secretary DILLON. I think that is correct. I do not think there has been any recommendation to reduce taxes in order to stimulate the economy, although it was seriously discussed in the spring of 1958, at the time an alternative decision was made to increase Government expenditures substantially, by some \$6 billion.

The CHAIRMAN. President Kennedy changed himself within a few months. He was very proud of the fact that the first budget he brought in had a surplus of \$500 million.

Now, we have three living ex-Presidents and two comments have been made. Former President Harry S. Truman, with his customary frankness, said that he opposed cutting taxes until the budget is balanced.

Mr. Truman said "I am old-fashioned. I believe you should pay no more than you receive."

Now, that was from Mr. Truman. Now, you served under President Eisenhower. I assume that you have great confidence in him. Am I correct?

Secretary DILLON. Yes, sir.

Senator BYRD. You were his right-arm in a great many matters, as I well know. On October 6 he said:

The President ought to tell us exactly what he is going to do when he is asking that taxes be reduced.

I think we ought to know more about administration expenditure plans. Civilization—

Continued Mr. Eisenhower—

has come to a point where you might call it a pension civilization.

And he said a great deal more along the same lines.

What I want particularly to emphasize is the fact that we are in a deficit spending period. I assume you will agree to that. The last 3 fiscal years, including the one ended last June were deficit years. We had deficits in those 3 years of around \$17 billion.

Now there is going to be another deficit in the present fiscal year. You admit that

Secretary DILLON. Yes; there is going to be a deficit.

The CHAIRMAN. You gave a figure once of \$9.2 billion. What is your figure now?

Secretary DILLON. It would be less than \$9.2 billion, as I said earlier in my testimony today. The original estimate submitted last January in the budget document was \$11.9 billion. However, several factors require a revised result. For one, economic conditions have improved, and we feel revenues will be somewhat higher, about a billion dollars higher than we earlier expected. Secondly, the date of effect of the tax bill as passed by the House of Representatives has been postponed to the first of 1964, which reduces its impact on this fiscal year by \$900 million. Also, we felt there will be a reduction of expenditures to around \$98 billion from the \$98.8 billion that was in the budget document. These factors produce a figure of \$9.2 billion. That, by the way, was the figure which was originally foreseen with no tax reduction at all. So now it looks as though we can have our tax reduction with the budget deficit no larger than we had foreseen without a tax reduction.

The CHAIRMAN. There is no doubt that it would be \$17 billion for the last 3 years—what was your estimate?

Secretary DILLON. It was \$16½ billion for the past 3 years, total deficit.

I am not prepared to make a final estimate.

The CHAIRMAN. You are speaking of fiscal year 1964, are you, which you estimate at \$9.2 billion?

Secretary DILLON. That is right.

The CHAIRMAN. What do you estimate the deficit at now?

Secretary DILLON. For fiscal year 1964. That is what I said, \$9.2 billion.

The CHAIRMAN. Now you have \$26 billion in 4 years. What do you estimate for 1965?

Secretary DILLON. Well, the estimate for—we have had \$16½ billion in the last 3 years, 1961, 1962, and 1963. If we have \$9 billion this year, that would be \$25.5 billion and then the President has said that he would submit a budget for 1965 with less than the \$9.2 billion that is presently foreseen this year, even though the full effect of the tax program will be in fiscal year 1965, which will be the year you will have the greatest effect from it.

So I would assume that it is something again in the order of \$9 billion. If you want to add that on to the others, it comes to a total of about \$34.5 billion.

The CHAIRMAN. That is \$35 billion in 5 years.

Secretary DILLON. 34½ billion.

The CHAIRMAN. But they are all estimates. I call attention to the fact that you and the President estimated a surplus in his first budget of \$500 million. Then in October 1962 you found out there was to be a deficit of over \$6 billion. So these estimates do not always come out.

Now we have gotten up to 1965. That will be 5 years of deficits. Now, what about 1966?

Secretary DILLON. We have no figure for 1966, Mr. Chairman. It will undoubtedly be substantially smaller, because by then the full effect of the tax reduction will be stimulating revenues and also a program of holding back expenditures will substantially reduce the deficit. But we do not have any figures for beyond 1965 and the 1965 figure is only that general statement, that pledge by the President which he made this summer, that he would bring in a budget with a deficit that was smaller than one we presently envisage for 1964.

The CHAIRMAN. If you have a deficit of \$9 billion in 1965, you will certainly have a deficit in 1966, will you not?

Secretary DILLON. I would expect so. We have said that, with stringent expenditure control and allowing for the growth in the economy, the earliest possible date we foresaw for a balanced budget from this tax bill was 1967, and that it might be 1968. It is either 1967 or 1968. We are in that area. As you recognize, it is hard enough to estimate 18 months ahead.

The CHAIRMAN. But it stands to reason if you had a deficit of \$9 billion one year, the next year is not likely to balance the budget.

Secretary DILLON. That is what I said, there will be a deficit in 1966.

The CHAIRMAN. So that will add 1 more year and then you have 1967 and so forth.

Dr. Arthur Burns, who has some standing as an economist—has been quoted as saying the budget is not going to be balanced under this plan until 1972. Do you disagree with him?

Secretary DILLON. Yes, sir, I disagree in that particular analysis. I have the highest regard for Arthur Burns. I think he is one of our outstanding economists and I think his judgments are very good, so this disturbed me when he made this estimate. We inquired into the assumptions he had used in making the estimate. He said he had taken an assumption that expenditures would continue to increase every year by the same figure and at the same rate as they increased in the first 2 years of this administration. He was assuming a \$5 billion increase in expenditures every year. But it must be remembered that during 2 base years we had a very large buildup in the defense and space areas. There is no reason to assume that will be the case in the coming years we are projecting. When you apply a more normal growth in expenditures, it changes his result considerably and brings it back to the 1967-68 area we were talking about.

The CHAIRMAN. As I see it, you have admitted to deficits in 1964, 1965, and 1966. Assume they stop then, we will have had 6 consecutive years of deficits.

What I am trying to bring out is my fear of these continuing deficits. It is bad enough if you have a deficit one year and a surplus the next year. But to continue for a long term in deficits, which definitely will continue for 6 years—you have admitted it would be 6 years, counting the previous 3 years.

Secretary DILLON. Yes, Mr. Chairman. I share with you your fear. We feel, however, that this program will stimulate our economy, produce relatively full employment, and put us in a position to reach balance.

If we do not have the tax cut and continue at our present high tax rates, we believe that there is less likelihood of reaching balance soon.

The CHAIRMAN. We all agree, I reckon, that we have had very able men in our Government since it was established. Now, if tax reduction is the panacea of all of the Nation's ills, why is it that one President or some Secretary of the Treasury in the past has not looked upon such a proposal as we have here as a panacea and recommended it before?

Secretary DILLON. We have, of course, studied history, Mr. Chairman. As a matter of fact, reports of Secretary Andrew Mellon, and also reports of the Budget Director at that time, indicate recognition of the principle we advocate.

They were operating in a different environment, an environment where they had budget surpluses which they felt were too large and they were trying, by tax reduction, to get rid of them.

The CHAIRMAN. I am not objecting to surplus.

Secretary DILLON. Their objection was every time they cut taxes, income increased so fast that it more than made up for the tax reduction and did lead to larger revenues than they otherwise would have had. Therefore, it is very similar to the proposal, the thinking, that we are advocating today. In effect, this has been the result in many of the countries of Europe which have done very well, such as Austria and Germany, who have had successive tax reductions.

Each tax reduction has led to greater revenues.

Of course, tax reductions cannot go on forever. When, however, you have a tax rate structure which is too high, and you bring it down to a more proper level, it is possible to stimulate the economy so that you will have greater revenue with lower rates. That is what we expect.

The CHAIRMAN. That is not the question I asked you. I asked you if any President had deliberately planned a deficit in order to give tax reduction.

Secretary DILLON. I do not think so.

And I do not think that President Kennedy has deliberately planned a deficit in order to give a tax reduction, because there will be a deficit with or without tax reduction.

The CHAIRMAN. It will be much more, will it not, if you reduce taxes by \$11 billion?

Secretary DILLON. For a temporary period, perhaps 1 or 2 years, the deficit would be larger than otherwise. On the other hand, if, without tax reduction, we have a slowdown in the economy or a recession sometime in the next year or 18 months, the result will be a bigger deficit than with the tax cut.

The CHAIRMAN. It is a great difference between having a small deficit and a large deficit. You are talking about 3 successive years very large deficits.

Secretary DILLON. Mr. Chairman, we have recent evidence of the effect of a recession. In 1959, because of a recession, and in spite of an administration that was strongly for economy, a budget supposed to yield half a billion dollars surplus wound up with a \$12.5 billion deficit.

That is bigger than any we are talking about.



The CHAIRMAN. Then you think the President has not planned a deficit by asking for a tax reduction when we are already in a deficit period?

Secretary DILLON. No; I believe the President has a program which he thinks will lead the country more quickly and more surely than any other route to a position of balanced budgets with reasonably steady full employment.

The CHAIRMAN. You admit to a deficit of \$9 billion for 2 years after the tax reduction is effective.

Suppose this tax, this panacea that you have thought about and nobody else has ever thought of, suppose it does not work? Some people are saying now that your tax reduction is not enough. Would you feel inclined, then, to have another tax reduction if this one does not prove to be the panacea you promise?

Secretary DILLON. No, Mr. Chairman. I would not. I would think that with the tax reduction we have, our tax rates would be more in line with other countries who have been able to have regular and rapid growth. I believe our tax rates would be proper. I think this program will work.

The CHAIRMAN. Mr. Secretary, I do not think we need to compare our Federal situation with any other country. England balances its budget. If the British run trade deficits and gold leaves the country, they put drastic restrictions on their citizens, even to the extent that they cannot take any English money out of the country. You think this bill is going to stop the flow of gold, as I understand it, and reduce the unemployment, and so forth.

Now, I have here a table prepared by the staff of the Joint Committee on Internal Taxation, which gives an interesting picture. It shows that individual taxpayers, with incomes of up to \$3,000, get a tax reduction of \$49 by the staff's figures. That is the average. At \$3,000 to \$5,000, the taxpayer gets an average reduction of \$67.

From \$5,000 to \$10,000 income, he gets \$90.

From \$10,000 to \$20,000 income, it is \$165 a year.

From \$20,000 to \$50,000, it is \$560 a year.

From \$50,000 and over, \$2,194.

The average reduction for an individual taxpayer would be \$110.

Now, how is \$110 a year per taxpayer going to spark any great improvement in the economy? Have you allowed for the people who are going to put whatever money they get in banks or pay off their debts?

Secretary DILLON. Yes, Mr. Chairman.

The record has been very steady. We had a \$7 billion tax reduction in 1954 which we can look to. There was no difference in spending habits in relation to income for the population as a whole.

It is true, of course, that for an average single taxpayer, the average workingman, the individual reduction which he will get is not large in dollars and cents. However, in the aggregate, this adds up to a very substantial amount of disposable income that will be spent. This will, in total, stimulate a very substantial additional amount of business in manufacturing to provide the wants of these individuals.

The real benefit to this type of individual will not come solely from the fact that his tax reduction gives him a hundred dollars more a year, or \$150 more a year or something of that nature. It will come from the fact that the economy will be stronger, that he will be surer of a job and

that a number of people, many people who presently have no jobs at all, will have new jobs. This is the real strength of this bill.

As you know, this is not a unique view. Last month, maybe less than a month ago, the Association of Business Economists, which represents all the leading economists who work for business companies, in accordance with their regular practice met to forecast the economy for next year. They showed in their forecasts that they believe that a tax reduction of somewhat less size than is scheduled under this bill, to take effect on the first of the year, would increase the gross national product by \$12 billion next year. There is, thus, a general feeling that a tax reduction will stimulate and strengthen the economy.

The CHAIRMAN. Let's take the \$49 reduction—that is about 15 cents a day, isn't it?

Secretary DILLON. Yes.

The CHAIRMAN. In that group, I imagine, there are a great many. It is on the earnings of up to \$3,000.

Secretary DILLON. No; the bigger number of people are in a slightly higher area. The average wage in manufacturing falls somewhere between \$5,000 and \$10,000.

The CHAIRMAN. \$2 a year is the average of all the taxpayers, that is what they would get. And I am concerned about this change of policy on the part of the administration.

Now, on January 30, 1961, the President said:

It is my current intention to advocate a program of expenditures which, including revenues from a stimulation of the economy, will not of and by themselves unbalance the budget.

At that time, he was a budget balancing man.

Then he said, when he presented his budget with a \$500 million surplus. He was very proud of that, and he said:

The administrative budget for 1963 shows a modest surplus of \$500 million. Under the present economic circumstances, a modest surplus of the magnitude projected above is the best national policy, considering all of our needs and objectives.

That was less than 2 years ago. Now, what has changed to completely reverse the position of the President?

Secretary DILLON. The President has not changed at all in his views. What happened was that the forecast of the economy on which that budget was based unfortunately did not turn out to be true.

The rapid increases in economic activity that characterized the third and fourth quarter of 1961 ceased abruptly on the first of the year of 1962. We reached a plateau. Our revenues did not increase as we had expected. Also, as a result, we continued to incur deficits. It became apparent that some action would be needed to stimulate our economy to remove this break which had caused recessions every time we began to look like we were reaching full employment, ever since the mid-1950's. It was for that reason that we developed this substantial tax program.

The CHAIRMAN. I want to quote you, Mr. Secretary, too. On Sunday, January 21, 1962, you answered a question by Lawrence Spivak on a "Meet the Press" television program, as to how important you

thought it was going to be for the United States to achieve a balanced budget in the fiscal year of 1963, which just ended. You replied:

I think it is a very important thing under the present circumstances, because we are in a period of prosperity where our revenues are high and it is essential under these circumstances to balance the budget.

Secretary DILLON. That is correct, only I turned out to be wrong, because the period of prosperity we expected, and thought we were in, leveled out. It did not increase.

The CHAIRMAN. Do we have less prosperity than we had the day you made that statement?

Secretary DILLON. We certainly did not continue our expansion at the rate we had been expanding every month up until the preceding December. I made that statement in January, when it was yet too early to foresee that the economy was leveling off.

The CHAIRMAN. Is not the stock market considerably higher than it was then? That is an index of prosperity?

Secretary DILLON. No, it is about the same. It may be a couple of points higher.

The CHAIRMAN. Is that a pretty good index of the prosperity of and the confidence of the people in the future?

Secretary DILLON. I think that it is a reasonably good index, but it deals with prosperity as people see it.

This is all relative. We could be a lot worse off. It is quite correct that we have done quite well. But we have not done anywhere near well enough. We have not made a dent in our basic problem of unemployment. We have not succeeded in increasing profitability and attracting business investments so as to increase business investment at the rate that is needed for a continuing, growing, strong economy. Something further is needed.

The CHAIRMAN. In other words, you anticipate a recession unless the Congress enacts a tax reduction adding \$11 billion to the debt?

Secretary DILLON. I, of course, cannot make a positive prediction whether, or when, a recession will occur. But certainly, based on evidence in the past, the length of past recoveries, unless all known precedents are shattered, we are entering a very delicate phase of this recovery. Because the average length of recoveries, as I have said, since the war have been some 32 months. We are 32 months now. The longest recovery is something like 37 months, which might give us 5 more months.

But unless there is something to break this pattern of cyclical recession that has been broken in Europe by proper tax and fiscal policies, we in the United States, I am sure, are going to continue in that pattern and have another downturn which will cost us far more in the form of deficits than what would be caused by the enactment of this bill.

The CHAIRMAN. Is that the opinion of the businessmen of this country, generally, do you think?

Secretary DILLON. I think many of them feel that and I think that is why there is such widespread support for enactment of the bill.

The CHAIRMAN. Most of them who have confided to me feel to the contrary.

I want to quote another gentleman who is here. He is Prof. Stanley S. Surrey, Assistant Secretary of the Treasury. He made a speech on October 25, 1962, 2 months after the President first announced that he was planning a top-to-bottom tax reduction. In that speech he said, and I quote him directly:

The effectiveness of tax rate reductions will be lost from the short-run point of view if they are accompanied by matching reductions in expenditures, even assuming such expenditure reductions where possible, which they are not.

Do you agree with that?

Secretary DILLON. I do not think it is possible to have expenditure reductions fully match a tax reduction of this type. It would require us to reduce our expenditures from \$92 to \$81 billion in 1 year. This is just not possible as a practical matter, without disrupting our defense and other programs vital to the country. But I do think we can hold down expenditures, hold them level. And it may be possible to have some reductions.

I was very interested in a statement made just 3 or 4 days ago on the floor of the House by the chairman of the House Committee on Appropriations, in which he reported to the House that the first four major appropriation bills that have been enacted in this session of the Congress, including the Defense Department bill, totaled \$339 million less than the same bills did last year. I think that is expenditure control.

The CHAIRMAN. Those reductions were not on an expenditure basis, were they?

Secretary DILLON. No; but they were the new appropriations and new obligations—

The CHAIRMAN. That does not mean a reduction in expenditures and supplemental appropriations have to be counted.

Secretary DILLON. It certainly does in the flow of time, because you cannot spend anything that has not been appropriated. If the appropriations stay level, the rate of expenditure is bound to level out later.

The CHAIRMAN. That does not necessarily mean that, because you have unexpended balances as of July 1 of \$87 billion.

Secretary DILLON. Yes; I said they will level out later. Expenditures follow appropriations by about 2 years, a year and a half.

The CHAIRMAN. But the money can be spent by the President without any further action of Congress, the unexpended balances already appropriated, \$87 billion.

Secretary DILLON. It can be spent and the Congress has asked him to spend it, directed him to spend it.

The CHAIRMAN. Well, it can or cannot be spent by the President as he chooses to do it.

Now, we have a Budget Director. I want to quote him, Mr. Kermit Gordon. He was quoted as saying to a congressional committee that a balanced budget would lead to increased unemployment, higher taxes, and a general economic decline. That was on January 23, 1963.

Now, who is it in the administration that thinks the budget ought to be balanced? The Budget Director does not think so. Mr. Surrey says it is going to be disastrous.

Secretary DILLON. I know the President thinks we should as soon as we can get our economy in shape so that we can have adequate revenues

from an adequately, fully employed economy. That is what he is working toward and has repeated his pledges many times. That is the basic policy.

Now, as far as these unexpended balances are concerned, there is a very real question of the extent to which the President can choose not to spend amounts which have been appropriated. In effect, this would involve an item veto; in other words, the right to decide that he will not carry out a particular project in a particular area any time he so desires. He would have the power which the Congress has specifically refused to give him, and which was covered very voluminously in the debate on this bill in the House.

He does not have that authority. At least, no President has ever felt he has that authority.

The CHAIRMAN. Do you approve of the reductions made by the House in the appropriations?

Secretary DILLON. In the appropriations to date?

The CHAIRMAN. Yes.

Secretary DILLON. Well, I think the committees looked at these bills very carefully and they decided this was adequate.

I am sure that they are responsible people.

The CHAIRMAN. Do you agree with the President when he denounced the House of Representatives, chastised them, said:

The action of the House today in drastically cutting the mutual security authorization is unprecedented, unwarranted, and unwise.

Do you agree with that? You said you agreed with the President. I wondered—

Secretary DILLON. I would like to point out that that action was taken on the floor of the House, and involved an authorization, not an appropriation. It was an overruling of a recommendation of a committee which had spent months studying the matter, and which had substantially reduced the President's requests. The House action took place before the Appropriations Committees had a chance to look at the bill. I would think it would have been more orderly to have allowed that bill to go through as recommended by its committee and then see what happened on this side. I think this was a totally arbitrary action.

The CHAIRMAN. You said a few minutes ago you approved of what the House had done. Now you do not approve of it.

Secretary DILLON. This was not an appropriation.

The CHAIRMAN. You approved of the fact that the President chastised the House of Representatives, which has equal responsibility with the President. It is a very unusual thing.

Secretary DILLON. I do not think it is up to me to approve or disapprove of that, and I do not think I should comment on that.

The CHAIRMAN. All right.

I promised another Senator to give him a chance to ask you a few questions.

I have just one more.

The temporary debt limitation expires November 30. What increase are you going to ask?

Secretary DILLON. Sir?

The CHAIRMAN. What increase in the debt limitation are you going to ask on November 30, when it expires?

Secretary DILLON. Well, we haven't had to reach a decision on that, although we will, very soon. I would say that one way—there has been talk originally of something like \$320 billion. Obviously, that is not necessary. However, during the period from the 1st of June last to the 15th of June, with at that time a modest cash balance, a minimum cash balance—it filled up later, but at that time it was a minimum balance, we were running at about \$306 billion. Now, if we have a \$9 billion deficit, \$9 billion on top of \$306 billion comes to 315. So it is pretty difficult to see how we can get by. That leaves no allowance for errors in computing. I would think something in that general area would be right. We have not made any definite decision.

The CHAIRMAN. Would you ask for an increase in a debt limit to cover the loss of a tax bill that had not then been passed?

Secretary DILLON. We would request, as we always do, a debt limit which would include a certain amount of flexibility for errors in judgment, for things that might develop. Now, if one wanted to say so, that could be said to include the reduction in the tax bill. The tax bill, if it becomes effective the 1st of January, would produce a net revenue cost of \$1 billion-eight, or approximately \$2 billion of that debt total.

The CHAIRMAN. In other words, you would ask for it up to January 1, is that it, and you would not ask for an increase in the debt limit to take care of a tax reduction that had not at that time been enacted by the Congress?

Secretary DILLON. I think we would ask for a debt limit—because we do not want to make the Congress act twice again next year on the debt limit. We would hope that that could be kept down to the one time. We would try to ask for a debt limit that could reasonably carry us through June 30, whether one said we would put in the 1.8 billion for the tax cut and a small, extra amount for a contingency. Or one could look at it and say we put in a larger amount for contingencies and one of the contingencies was the possibility of a tax cut.

The CHAIRMAN. Then you will ask for an increase in the debt limit sufficient to take care of the loss from the tax cut?

Secretary DILLON. That is right.

The CHAIRMAN. Although the tax cut has not been enacted by Congress? You will do that?

Secretary DILLON. That is the figure we would submit.

The CHAIRMAN. You have been in office since January 1961. How many times have you asked for an increase in the debt limit?

Secretary DILLON. It is many times. This year, only once so far. I asked for it to be continued once, so we had to have two laws. But one of them was only a continuation.

The CHAIRMAN. How much has the debt limit been increased during your term of office?

Secretary DILLON. It is now \$309 billion. I think it was \$293 billion when I first came into office.

The CHAIRMAN. How much has the actual debt been increased?

Secretary DILLON. Actual debt about \$15 billion.

The CHAIRMAN. Senator Long.

Senator LONG. Mr. Secretary, I have read your statement. I think I agree with about 90 percent of what you had to say.

As you know, I personally tried to urge upon this administration that we should have both a reduction in the level of interest as well as a tax cut. I have had no success in the first part because you people have felt that a reduction in the level of interest rates would entail a number of other problems which you are not prepared to undertake at this time.

Now, if I understand it, your basic argument is that without a tax cut, we risk a recession and that with a recession, our deficit will be much greater than anything projected here in this statement.

Secretary DILLON. That is correct.

Senator LONG. In other words, if we so led this Nation that we have a large amount of persons and plants unemployed next year, we will have a recession far beyond anything anticipated here and we hope to avoid that by this tax cut.

If there were no recession, you would still hope to have a more full employment of persons and productive facilities next year.

Secretary DILLON. That is correct. I am not prophesying the exact time of a recession; it could be next year or the year after. But we certainly could get one and I think we are reaching the critical stage now where it might well come next year if we do not have the tax cut.

Senator LONG. Right.

Now, Mr. Secretary, I personally favor tax reduction that helps all hardship cases with regard to taxpayers. So far, I think that there has been a reluctance on the part of Congress to give tax reduction of any substantial amount in the upper income brackets, notwithstanding the fact that those people are paying very nearly confiscatory taxes. Just looking at the tables here, for example, if a person actually pays taxes on \$100,000 of income that he makes nowadays, he pays \$67,320 in taxes. That leaves him \$32,600. If he pays taxes on \$200,000 of income, he will keep \$43,180 and he will pay \$156,800 in taxes.

If he makes an additional \$300,000 and pays taxes on it, he would retain \$27,000 out of that \$300,000.

Now, I think that you and I know that most people who make a lot of money, if they are able to anticipate that they are going to make it, are going to go to a tax lawyer or a good tax accounting firm—I could name a number of them but I shall not for fear I might ignore somebody—and they would advise him of a number of things he could do to keep his tax liabilities low.

For example, he could invest money in tax-exempt securities. He could invest it in State or municipal bonds or subdivisions and agencies.

He could set himself up as a private foundation and make contributions to that private foundation and deduct amounts that he put into that.

He could set up a number of corporations with a qualified pension and profit sharing plan on which he would pay no tax on the amount that was contributed for his benefit.

He could benefit from trust income accumulated for his advantage. He could benefit from interest paid on indebtedness for property that was owned for personal use.

He could engage in a number of transactions where he would have an interest expense and where the income would be taxed only for

half, and that half at 50 percent, which works out to an overall tax of 25 percent for his profit, with a complete deduction for the interest expense that might finance that capital transaction.

He could go in the oil business and drill a bunch of wells and take the intangible drilling costs for a deduction, which oftentimes works out to as much as 80 percent.

He would have the advantage of percentage depletion in that industry as well as a lot of others.

Now, I have discussed with you on occasion the possibility of providing an alternate method where a taxpayer could waive the benefit of all of these proposals, all of these tax avoidance measures, as well as a number of others, and thereby be taxed at a more reasonable rate on a lot more income.

I would like to ask you if you believe that the Treasury could look with favor on some such proposal along that line, to give a tax deduction at a lower rate to a person who would elect to pay taxes on practically all of his income.

Secretary DILLON. There has always been a great deal of attraction from the point of view of simplicity, Senator, to a tax on gross income, which is more or less, I imagine, what you are talking about. There was some discussion of this in committee, the Ways and Means Committee, on the possibility of providing such a scheme.

The great difficulty we found there was a difficulty, if it went all the way up and down the line, of estimating what the revenues would be and what the actual loss of revenue would be. We do not have all the necessary information. For instance, we do not know what the holdings of individuals are in the form of State and local bonds carrying tax-exempt interest. If they had the option of choosing a method which would require the inclusion of that interest income, we would increase their income. However, we do not know how much. We were not able to make a recommendation or come to any conclusion at that time for the House.

If there is any way in which progress can be made here, with a minimum of revenue cost to the Government, I think it is something that we, and I would think all tax lawyers who work with this complicated code, would welcome as a first step to simplify drastically our tax code. I believe major simplification can only be accomplished through an optional alternative rather than through a direct abolishing of all the various special privileges which are presently in the code. I think experience has led to the conclusion that that latter alternative is not practical. If you have an optional alternative, we will be glad to study it carefully and report upon it fully later.

Senator LONG. As I understand the previous statement you made in here about this subject, you feel that to go into this field carries the danger of a very serious miscalculation if you try to extend it all the way up and down the entire gamut of the rate.

Because, in the middle income brackets, a miscalculation or perhaps a loophole that you had not thought of at the time that you recommended it could perhaps lead to a loss of billions of dollars.

Would you be willing to consider exploring the possibilities of trying this system with regard to those who are paying in brackets of 40 percent and above?



Secretary DILLON. Well, I think if you can find some method of minimizing the revenue impact, we will be glad to study it. I think it might be a worthwhile experiment, based on the fundamental idea, which I assume to be your idea, Senator, that if the option worked in those higher brackets, it might provide a mechanism as we learned more about how it worked, to extend it throughout the income scale so that all taxpayers could have this alternative.

Senator LONG. Mr. Secretary, your Department has provided me with a number of interesting studies. For example, here are two taxpayers with a gross income of better than \$300,000. One of them paid 71 percent of his income in taxes. The other paid 4 percent. I believe I have another study here where two taxpayers, one with \$1,280,000, almost \$1.3 million, paid taxes that amounted to two-tenths of 1 percent of his gross income, while the other, with \$600,000, roughly, paid 75 percent. I would like to ask you if equity does not favor doing something for the taxpayer who, instead of going out at the first of the year and planning this thing, to set up a foundation and put his taxable income into a foundation, and setting up a lot of owner-manager corporations and buying stock with borrowed money in growth corporations, which would increase in value subject to eventual capital gains, that we rather try to provide an acceptable alternative to a person so he will not feel this pressure of coming to Congress and asking for additional special advantages, and so he will be tempted to go ahead and make the money that he would earn and pay taxes on it as ordinary income?

Secretary DILLON. The average tax rate of the very high income people, who have incomes of several hundred thousand dollars and up, is under 50 percent. This is the result of the various measures that are used to avoid the payment of excessively high tax rates, and it is one reason for reducing the high rate from 91 percent down to something that is more normal. People will hopefully devote their time to their business rather than to reducing taxes.

And I would think anything in the general order of limiting the tax rate to 50 percent at the top could be worked out without any substantial loss in revenue. I do not think it is worth substantially losing revenue for it at this time. But I think it probably could be worked out that way. It might be a good example, because there has been so much talk and so much desire among the accountants, tax lawyers, the American Bar Association, and the tax institutes of finding a method to simplify the tax code.

Senator LONG. Did it occur to you that if we do do something of this sort, it might reduce the pressure, both on you and on us, for all sorts of rulings and changes in the law such as many I have seen here, to provide additional special advantages to taxpayers who complain they are being crucified by confiscatory tax rates?

Secretary DILLON. It might very likely, yes. I think it would, Senator.

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

The CHAIRMAN. Mr. Secretary, I want to put into the record a statement from the staff as to the increases in taxes on various items. If you have any objection or criticism of it, I will be glad for you to insert your statement in the record. They show that the increase in taxes is something over a billion and a half, I believe.

(The document referred to follows:)

OCTOBER 14, 1963.

HON. HARRY F. BYRD,  
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In the briefing session of October 10, you asked for a list of the structural changes in the bill under consideration which might increase an individual's tax. These together with their estimated revenue impact in a full year of liability are as follows:

1. *Repeat of dividend credit and doubling of dividend exclusion.*—The 4-percent dividend received credit is reduced by the bill to 2 percent for 1964, and repealed for subsequent years. The \$50 dividend exclusion is increased to \$100 (usually \$200 in the case of married couples) for 1964 and subsequent years. This is expected to increase revenues by \$300 million.

2. *Group term insurance.*—The bill limits the employee exclusion for premiums on group term insurance furnished through the employer to premiums paid for the first \$30,000 of coverage; it also provides a special deduction for employees who are in effect part of paying someone else's insurance costs in the case of coverage above \$30,000. This is expected to increase revenues by \$5 million.

3. *Sick pay exclusion.*—The bill restricts the sick pay exclusion, of up to \$100 weekly to those who are out of work for more than 30 days (and makes the exclusion available only for the period beyond that time). This is expected to increase revenues by \$110 million.

4. *Deduction of certain State and local taxes.*—The bill denies a deduction in computing income subject to Federal tax for State and local taxes other than property, income, and general sales taxes (the principal taxes for which a deduction is denied are gasoline, auto license, alcoholic beverage, cigarette, and selected excise taxes). This is expected to increase revenues by \$520 million.

5. *Casualty loss deduction.*—The deduction for personal casualty and theft losses is limited to the amount in excess of \$100 per loss (similar to \$100 deductible insurance). This is expected to increase revenues by \$50 million.

6. *Charitable contribution deduction.*—The bill denies charitable contribution deductions for future interests in tangible personal property until the gifts are completed except where the property is retained for the life or lives of the donor or donors. This is expected to increase revenues by a negligible amount.

7. *Bank loan insurance.*—An interest deduction is denied for amounts borrowed under a systematic plan to pay premiums on life insurance (certain exceptions are provided). This is expected to increase revenues by \$5 million.

8. *Personal holding companies.*—The tax treatment of personal holding companies is made considerably more restrictive. For example, the percentage of passive income which may result in a company being classified as a personal holding company is reduced from 80 to 60 percent and amendments are made so that the tax cannot be avoided by using rental or oil or gas or mineral royalties (or working interests) to shelter substantial amounts of investment income, such as dividends and interest, from the personal holding company tax. A number of other restrictive amendments are also made. On the other hand, relief is provided for those companies which are not now personal holding companies, but which would be under the new definitions. This is expected to increase revenues by \$15 million.

9. *Aggregation of oil and gas properties.*—For the future, oil and gas leases or acquisitions are no longer to be aggregated in determining what constitutes a property for purposes of computing the percentage depletion deduction. This is expected to increase revenues by \$40 million.

10. *Multiple surtax exemptions.*—For corporations where there is common control to the extent of 80 percent or more, the corporations involved generally are limited to one \$25,000 surtax exemption for the group or alternatively required to pay a special tax of 6 percent on the first \$25,000 of their income. No penalty tax is imposed where a consolidated return is filed for the group. This is expected to increase revenues by \$35 million.

11. *Interest on certain deferred payments.*—Where property is sold on an installment basis and either no, or very low, interest is charged on the installments, the bill provides that an appropriate amount of each installment is to be treated as if it were an interest payment. This is expected to increase revenues by a negligible amount.

12. *Reimbursed medical expenses.*—The bill includes in gross income reimbursed medical expenses to the extent the reimbursement exceeds the actual medical expenses incurred with respect to the illness or accident. This is expected to increase revenues by a negligible amount.

13. *Stock options.*—The present tax treatment of employee stock options is further restricted, the principal additional restrictions being that (a) the stock when acquired must be held for 3 years or more; (b) the option must not be for a period of more than 5 years; (c) the option price must at least equal the market price of the stock when issued; (d) stockholders' approval for the options must be obtained; and (e) the extent to which new options may be exercised when the old options are outstanding is restricted. Separate tax treatment is provided for employee stock purchase plans which are available to all employees on a non-discriminatory basis under rules which are substantially the same as under present law. This is expected to increase revenues by a negligible amount.

14. *Sale or exchange of depreciable real estate.*—In the case of real estate sold at a gain in the future, depreciation deductions, generally to the extent these deductions exceed depreciation allowable under the "straight line" method (to the extent of the gain), will be treated by the bill as giving rise to ordinary income. However, in the case of property held more than 20 months the amount treated as ordinary income will be reduced by 1 percent for each month of holding over 20, with the result that no amount will be treated as ordinary income in the case of real property held more than 10 years. For the fiscal year 1965, this provision is expected to result in a revenue gain of less than \$2.5 million but in subsequent years when the provision becomes fully effective it is anticipated that it will result in revenue gain of approximately \$15 million.

Sincerely yours,

COLIN F. STAM,

Chief of Staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. I also want to insert in the record a statement from the Joint Committee as to how much the average reduction will be.

(The document referred to follows:)

*Estimated average annual tax reduction per individual income taxpayer<sup>1</sup> under H.R. 8363 when fully effective—By adjusted gross income class*

Adjusted gross income class:	Average annual tax reduction <sup>2</sup>
0 to \$3,000.....	849
\$3,000 to \$5,000.....	67
\$5,000 to \$10,000.....	90
\$10,000 to \$20,000.....	165
\$20,000 to \$50,000.....	560
\$50,000 and over.....	2,194
All taxpayers.....	110

<sup>1</sup> Joint returns counted as 2 taxpayers.

<sup>2</sup> Including capital gains without induced effects; and before feedback.

Source: Staff of the Joint Committee on Internal Revenue Taxation, Oct. 14, 1963.

The CHAIRMAN. If you have any criticism to make of those two statements, the chairman will be glad to insert it in the record.

(After reviewing the table submitted by the chairman, Secretary Dillon subsequently made the following statement:)

When Chairman Byrd was interrogating me, he submitted a table for the record, and asked our comments on it, and it was a table which indicated the size of the reduction per taxpayer in these various brackets.

We have looked at that calculation and we discovered that in arriving at it, the calculation which was prepared by the committee's staff was not based per taxpayer but took a joint return, which is one taxpayer, and counted it automatically as two taxpayers, and therefore it came up with some figures that were smaller than if you figured a husband who was working and is the taxpayer, and happens to be married and has a wife, he is one taxpayer.

If you take all taxpayers, the reductions are somewhat larger, and I think that since Chairman Byrd asked me to comment on that, I would like to submit this table for the record, which shows his table and the other table is submitted per taxpayer. The differences are not tremendous, but they are different. I think they ought to go in the record at the place where he asked me to make a comment.

Senator SMATHERS. Without objection we will make that a part of the record.

Secretary DILLON. Thank you.

(The documents referred to follow :)

*Estimated average annual tax reduction per taxpayer under H.R. 8363 when fully effective, by adjusted gross income class*

Adjusted gross income class (in thousands of dollars)	Tax reduction (Joint committee calculation) <sup>1</sup>	Tax reduction <sup>2</sup>
0 to 3.....	\$49	\$57
3 to 5.....	67	100
5 to 10.....	90	159
10 to 20.....	165	312
20 to 50.....	560	1,020
50 and over.....	2,194	2,625
All taxpayers.....	110	174

<sup>1</sup> As estimated by Joint Committee on Internal Revenue Taxation (Oct. 14, 1963) and shown in table which treats joint returns as 2 taxpayers. Table is labeled "Estimated Average Annual Tax Reduction Per Individual Income Taxpayer."

<sup>2</sup> Excluding capital gains; joint returns counted as 1 taxpayer.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 17, 1963.

The CHAIRMAN. Senator Williams?

Senator SMATHERS. I will be very happy to proceed if the Senator from Delaware is not yet ready.

I have just a few questions.

Senator WILLIAMS. I am ready. I just thought it would be easier if we could finish while we are at it. I did not think we had time to finish today so if you can finish now—

Senator SMATHERS. I will be glad to finish my questioning within the next 10 minutes.

Mr. Secretary, I think it is well to get on the record, do you favor a balanced budget or do you not?

Secretary DILLON. I certainly favor a balanced budget.

Senator SMATHERS. Do you think the President of the United States favors a balanced budget?

Secretary DILLON. I know he does.

Senator SMATHERS. Do you foresee any way that we will be able to balance this budget except in the manner which you have recommended, which is to have a tax-reduction bill?

Secretary DILLON. I think this is the best and surest way to do it, because we tried hard, not only in this administration but past administrations, and the results have not been good. They have succeeded occasionally in having a bare balance or a very small surplus and the result then has been that we have been thrown into a substantial recession with deficits that are far larger than anything that is expected under this bill.

Senator SMATHERS. Is it your observation that most of the businessmen for whom you have respect and most of the economists that you know and for whom you have respect recommend this as the only method, this tax reduction as at least the best method of achieving a balanced budget?

Secretary DILLON. It certainly is. This has been a very remarkable thing, the growth of this consensus. I think it was a rather new thing when it was discussed first last January or February. But certainly, the business community, as I know it, has come to substantially support this method, this way of operating to achieve our objective of a balanced budget in the future and certainly, the great majority of economists, both here and abroad, feel this same way.

It is very interesting that at the session of the International Monetary Fund 2 weeks ago, where we had a chance to talk with finance ministers and central bankers of Europe, who were conservative men, it was the unanimous opinion of these gentlemen that this was the right and conservative course to follow.

Senator SMATHERS. Now, Mr. Secretary, do you know offhand how many years in the last 20 or 25 years that we have had deficits, unbalanced budgets? Do you recollect?

Secretary DILLON. I do not recollect that exact figure. But we have probably had five or six surpluses.

Senator SMATHERS. There has been reference made to Arthur Burns as an economist. Do you recollect that in 1958, I think it was; the chairman has pointed out that you were then a part of that administration, whether or not the Secretary of the Treasury had predicted a \$500 million surplus?

Secretary DILLON. Well, there was a prediction in the budget message of a \$500 million surplus for fiscal 1959. It was submitted in January of 1958. The Secretary of the Treasury submitted the revenue estimates and the Budget Director the expenditure estimates.

Senator SMATHERS. And how far off was the actual fact from the prediction, do you recall?

Secretary DILLON. In total, it was some \$13 billion off. The revenues were about \$6½ billion less than expected because of the recession. The Congress and administration acted to alleviate the effect of this recession, particularly on unemployment, by increasing expenditures in 18 months by \$6½ billion. That made the total of \$13 billion deficit.

Senator SMATHERS. Would that not indicate that possibly economist Arthur Burns' statement that there would be no balanced budget under this proposal until 1972, that that, too, might be subject to some error?

Secretary DILLON. Well, yes. I said I think he made an erroneous assumption when he took the assumption of an annual \$5 billion increase in expenditures.

I have talked with him about it, and he frankly recognizes that if you take a smaller increase in expenditures of, say, \$2½ billion on an average, which is a figure that I take because this is what, in his final report as Budget Director, Mr. Maurice Stans said he felt was the annual built-in increase because of population increases and factors of that nature. If you took that assumption, Arthur Burns readily

recognizes that the time of balance would be much earlier than he had prognosticated in his figures.

Senator SMATHERS. Now, Mr. Secretary, if we have a recession in the next year or so without a tax reduction, what would you expect the deficit to be? How high could it conceivably go?

Secretary DILLON. Well, that is a difficult question to answer. But if we follow the antirecessionary program of 1959, and the same thing happened as happened in 1959, where revenues fell by \$6 billion and we added \$6 billion of expenditures, the deficit would be up in the area of between \$15 and \$20 billion.

Senator SMATHERS. Mr. Secretary, we have heard some complaints about cutting taxes at a time when Government spending is high. What is the record in this administration on spending by the Government since it took office, with respect to nondefense spending?

Secretary DILLON. The record with respect to nondefense spending is very good. Our nondefense spending has actually increased less in the 3 years 1961-64 than the nondefense spending increased in the preceding 3-year period 1958-61. I am including in the defense category the space budget, which has gone up very rapidly.

But excluding those two categories, all other expenditures of the Government have increased less rapidly than they did before. One rather notable example was brought to my attention just the other day by the Budget Director who will be able to testify in more detail if you want. He told me that he had just received figures on general Government employment to the end of August. They showed that in regular Government employment, the total increase in the 12 months ended last August 31 was 78 people. In other words, civilian employment has been held absolutely level.

I think that is expenditure control in action.

Senator SMATHERS. Now, it is your understanding of the President's position that the administration expects to hold down Government spending wherever and whenever possible?

Secretary DILLON. Yes; the President has a very strict program on personnel in particular, expenditure ceilings on new personnel. Let's take the example of what has been done in the Defense Department. Although their appropriations have gone up, because we have bought a tremendous amount more of defense, nevertheless they made some very substantial savings in their methods of operations amounting to billions of dollars evidenced by the reports of Secretary McNamara.

Senator SMATHERS. Mr. Secretary, we have heard a good deal in the past couple of weeks about different ways of comparing the tax reduction that goes to different income levels.

The ratio of tax reduction to tax, the ratio to income after tax, and various other methods. I find this situation a little bit confusing. What, in your judgment, is the most accurate way or method of computation to determine who gets, in fact, the savings under this tax bill?

Secretary DILLON. Well, I think if you are talking about tax reduction, which the President has been talking about over the past year, the way to look at it is to look at the dollar amount of tax reduction, and what percentage there is of reduction in taxpayments.

There are, of course, ways one may look at it other than from the viewpoint of tax reduction. Thus, there is no doubt that a man who pays very little in taxes out of his total income will not receive a very

big addition to take-home pay from tax reduction. He would not have much addition in take-home pay if he paid no taxes at all.

On the other hand, if you are going to reduce the rate structure in our highly progressive rate system, going up to 91 percent, it is bound to be that anyone who actually pays a high rate like that, will get a relatively large addition to after tax income if you reduce his tax from 90 to 80 percent, what he has left if he were actually paying 90 percent, is twice as much. In this case it would double. Although that is a perfectly valid computation, I do not think it is a computation that deals with tax reduction.

I think the logical computation is to show the percentage reduction in tax, because that is what we are talking about, reduction across the board of tax rates.

Senator SMATHERS. According to your statement, that the highest percentage of reduction actually goes to those in the lowest income groups?

Secretary DILLON. Yes; on table 4 of my statement, it shows that those with adjusted gross incomes of under \$3,000 get an average reduction in their tax, which is a very small tax, but they get an average reduction of 38.3 percent, whereas those with \$50,000 and over of adjusted gross income get an average reduction of 12.6 percent.

So they get a smaller reduction in their percentage, but they get more actual tax saving because there are fewer of them.

Senator SMATHERS. Now, Mr. Secretary, in your statement, there was a section that small businessmen will benefit under the pending bill. I read the section but you had skipped over it in your presentation this morning. I would like to ask you a question with respect to this small business section.

The four-point cut in the overall corporate tax is well and good to help the bigger companies, but will this bill actually have much of an impact on helping the small business in our economy?

Secretary DILLON. Yes. I think it will have a very real impact, because by reducing the normal rate from its present 30 to 22 percent in small business—that is, business with a \$25,000 income, in that area, will have a reduction in its taxes of nearly 27 percent, over 26 percent, which is very substantial.

They need this very much. This has been something that all students of the small business area have worked for and wanted and felt was fair for a long time. And certainly, this is very heavily supported by all the small business organizations for that reason. It will actually—their earnings are again not very big, so when you talk in millions of dollars, it will not be anything compared to the tax reduction that the very big corporation gets with its 4 percent. But it will about double the amount of tax reduction going to small business over what they would get with a strictly proportional cut.

Senator SMATHERS. Mr. Secretary, in my State, I have a number of people who are elderly and retired and have for their income only interest and dividends. Will they be adversely affected by this bill with its provision providing for the repeal of the dividend credit?

Secretary DILLON. I do not think any of them would be adversely affected at all. In fact, I am sure they would not. There has been some discussion of this, so I would like to make the point. What has been talked about are retired individuals who have no source of income

other than dividends, and with retirement income credits. A married couple in this category would have to have about \$200,000 in stock holdings before becoming subject to tax at all under the House bill. In terms of income, they would not be subject to tax liability unless their dividend income exceeded \$6,250. At the average current rate of return on stocks, taken from Standard & Poor's average yield on 500 stocks of 3.2 percent, they would have to have stock holdings worth \$195,000.

If an elderly couple has a higher, a larger amount of stock holdings, say \$250,000 worth of stock, and gets \$8,000 worth of income from it they would under present law have to pay \$156 of tax, provided they can claim the maximum retirement income credit, both of them.

If they could not, they would pay more.

Under the House bill, the tax on the same dividend income of \$8,000, would go up to \$281, which from \$156 would be an increase of \$125. Some people have concluded from this that a few people with considerable stock holdings within this area would actually pay more under this bill. However, such a conclusion fails to take into account the corporate rate reduction under the House bill.

The corporate rate reduction will increase corporation after-tax income by  $8\frac{1}{3}$  percent. Undoubtedly, corporations will pass a portion of that increased profit on to their stockholders, which are the owners of the corporation. If corporations pass through the same percentage of the increase that they are paying now in dividends, this same elderly couple we have been talking about would wind up with after-tax income of \$8,720, or some \$900 more than they have under the present law, so they would be very, very much better off.

You can take a more conservative estimate of the amount that would go through, but the after-tax income of this couple would still be larger than it is now. So I think it is fair to say that no one would actually be in a worse situation because of the repeal of the dividend credit.

This only applies to those using the full retirement credit or close to it. Those under 65 and those over 65 who do not have this credit would pay less in any event. The problem arises because the dividend income under present law gives a double benefit first as the dividend credit and also retirement income for the retirement income credit.

Senator SMATHERS. Thank you, Mr. Secretary.

Now another question. Would a sick pay exclusion affect the income of retired persons by excluding up to \$100 of income?

Secretary DILLON. Not at all. That would remain exactly what it is now. What the House simply did was say that you could not have the benefit of the sick pay exclusion unless you had been absent from work for 30 days. Anyone who is disabled or retired because of disability has obviously been away more than 30 days, so they will continue just as they are.

Senator SMATHERS. All right, Mr. Secretary.

Now, several of us, in fact, almost everybody in the Senate, has introduced some kind of a bill to permit older persons of limited means to sell their residences when they reach retirement age without being subject to a capital gains tax in the process.

Does this House bill include that provision?



Secretary DILLON. Yes; this was not one of our original administration recommendations, but it was put in by the Ways and Means Committee.

We accepted the suggestion. There is a provision in the bill which relieves people 65 years and over of a capital gains tax on houses up to \$20,000 in value. If the house is over \$20,000 in value, they get relief in the proportion of the capital gains the \$20,000 bears to the sale price of the house.

Senator SMATHERS. The bill as passed by the House would restrict the application of the new 5-year carryover for charitable contributions made by corporations to those contributions made in the taxable year 1964 and subsequent years.

Would the Treasury Department be opposed to allowing the extended carryover to apply to contributions made in prior years?

Secretary DILLON. No; and it was not thought of in the House.

But since then, we have heard that there was some interest in that. We see no reason, if the committee wants to do that, to object to that along the lines of the capital loss carry over provisions of the bill. We do not think it would add any significant revenue cost.

Senator SMATHERS. Mr. Secretary, the capital gains rate provisions of the House bill include retaining present law, 50 percent inclusion and 25 percent maximum for so-called statutory capital gains.

When you said in your statement that the capital gains rate provisions of the House bill are unacceptable, does this mean that you are now asking for a change in present law as to these statutory gains?

Secretary DILLON. No. There has been some misunderstanding of that. I have tried to make it clear. What I actually said is that all we are objecting to in the capital gains field is the change in the inclusion percentage from 50 to 40 and cutoff at 21 percent rather than 25 percent.

Senator SMATHERS. Now, Mr. Secretary, the House bill provides that the new restrictive rules for executive stock options will be applicable to options elected after June 11, 1963. As you know, the language of the House bill was first made public on September 10 of this year. As I read the bill, corporations issuing options during the past summer are obligated to abide by the new rules before they even had copies of those rules. Is not that an unreasonable retroactive application of the rules?

Secretary DILLON. Yes. I think it was an unintentional occurrence. The House, when they made their decision, which was on June 11, was under the impression that they would complete their work very rapidly and have a draft available. As you know, the draft did not become available until September. What happened was that many companies, or a number of companies, tried to follow the precepts laid down in the House bill, because they had been told what they were in general but not having the complete text, they could not follow it exactly.

So therefore, a number of them made arrangements which are not quite in accord with what is in the House bill. We would think that the best way to handle this would be to give any company that issued options after the June 11 date until January 1, 1965, to revise their options without any cost to the employee or to themselves to conform to the bill as it is finally enacted.

That should give them plenty of time. We do not, on the other hand, think it would be fair to change that June 11 date entirely. Many companies tried to follow the spirit of the June 11 decision. A few others may have made no such attempt. It would seem unfair to give the benefit to those who made no attempt to follow the desires of the House of Representatives, over those who did attempt to conform.

But with such an amendment allowing a change to bring these stock options into accord with whatever Congress finally decides, I think it would be all right.

Senator SMATHERS. One last question :

In view of the fact that most economic indicators are good these days, would you once again just state why you have the feeling of urgency with respect to the need for the adoption of tax reduction legislation this year, rather than possibly next February or March, making it retroactive to January 1, 1964?

Secretary DILLON. In the first place, while I am no economist and no believer in the infallibility of economic indicators, the facts are that the economic indicators are not good right now. A number of those which are supposed to lead general business have leveled out and dropped down and there is no indication of strength in them at all. In addition, and my basic reason, is that a number of things that have maintained the economy have run through their usual cycle. We have had a very big increase in housing, in construction. And it is difficult to see this carrying on and increasing any further.

We have had two very excellent automobile years. That is very important. While I foresee another good one, it is difficult to see a still better one giving any impetus to the economy.

We have had a very big defense program, which has increased Government expenditures over the last few years. That has leveled out now and there will not be the stimulus from that area.

So about the only area that one can look to, that usually comes along in the later stages of economic upturn to give it continued life, is renewed and substantially increased investment in plant and equipment. While such investment has increased recently, it has not increased sufficiently to give assurance that we can continue next year to move ahead at the rate we have been doing this year. In this connection, I think it is vital that we get a tax bill decision promptly. This is the time of year that businessmen make their decisions for new investments, decisions which affect next year's action.

I would again just cite the estimates of the business economists, hundreds of them, who met and felt that the economy would continue a satisfactory level of increase with a tax cut in January, slightly smaller than the one in this bill. Although I think they were talking of a \$4 to \$5 billion reduction while this is a \$7 billion reduction, at the same time, they answered that if there were no cut, they felt that the GNP would be \$12 billion lower. Effectively, we would be at an absolute plateau in GNP for the latter part of next year, which means recession and increasing unemployment. Our experience of 1960 would be repeated.

Senator SMATHERS. To what specific situation do you refer?

Secretary DILLON. This was the consensus of the National Association of Business Economists, economists who work and advise the banks and business interests throughout the country. It was their combined opinion made recently in their current annual prediction.

In effect, what they are saying is that with no tax cut, there will be a recession next fall.

Senator SMATHERS. Thank you, Mr. Secretary, for your appearance this morning. A number of Senators, I think, want to question you. Will you be free several more days this week?

Secretary DILLON. I am at your disposal, Mr. Chairman, of course.

The CHAIRMAN. We will meet tomorrow at 10 a.m.

(Whereupon, at 12:35 p.m., the committee recessed, to resume Wednesday, October 16, 1963, at 10 a.m.)



# REVENUE ACT OF 1963

WEDNESDAY, OCTOBER 16, 1963

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

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

Present: Senators Byrd (chairman); Long of Louisiana; Smathers, Anderson, Douglas, Gore, Talmadge, McCarthy, Ribicoff, Williams, Carlson, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair recognizes the Senator from Delaware, Senator Williams.

Senator WILLIAMS. Mr. Secretary, yesterday in your testimony as I understand it, with one exception, the provision relating to capital gains, you were endorsing the provisions of the House bill without any changes; is that correct?

## STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY—Resumed

Secretary DILLON. I was not asking for any other changes, because of the need, the overwhelming need, to have prompt action on this tax reduction bill.

Senator WILLIAMS. Then it is correct to say that with that one exception, you are recommending that the bill be approved without any further modification?

Secretary DILLON. The bill is acceptable to us without any other modification and we recommend it be approved.

Senator WILLIAMS. Does that mean you are abandoning the provisions which you initially recommended that were not adopted by the House, the so-called reform measures which were originally a part of the President's recommendations?

Secretary DILLON. It means that these recommendations, a great many of them, are already in the bill. With respect to those which were not adopted after very considerable debate and discussion, and a showing that there was a substantial disagreement, we feel that they are matters that would not be likely to be resolved any more rapidly here. The delay that would be caused by trying to reconsider all of these would be very bad for the country and for the economy.

We do not in general abandon our feeling that they were proper recommendations at the time, and appropriate revisions to the tax system.

But from the point of view of the overriding necessity, as the President has pointed out, of having a tax bill enacted at this session, we feel that we have to take account of public opinion as shown after extensive hearings in the other House, so we are prepared to leave those aside. That is why we are recommending the bill as it came from the House.

Senator WILLIAMS. Are they being laid aside temporarily or permanently or will you be back in next year asking for the enactment of those same recommendations?

Secretary DILLON. There has been no decision as to what would be done next year in view of the fact that there will be a general election next year. There is the general feeling that it would not be possible to have as heavy a legislative schedule, so I doubt if we would come back next year with any major tax legislation after we got finished with this bill.

Senator WILLIAMS. Then do we understand that those controversial provisions are going to be carried over and brought back after the election is out of the way?

Secretary DILLON. The bulk of them are provisions that would be improvements in the tax system.

I think one or two of them we have changed our mind on, the 5-percent floor in particular. I don't think we would come back with that recommendation again.

Of the rest, a few of them were left out of the bill that are very valuable. Certainly we think that recommendations in connection with improving tax treatment of the aged was a substantial advance, but they were highly complex, and the House largely, because of lack of time there, put those aside and said, "Let's take them up some other time," and I think there might very well be a time when we would recommend improving the tax treatment of the aged again, because I think they deserve it.

Senator WILLIAMS. It still boils down to the point that the House pretty much approved the provisions which were rather popular, and they will be enacted if the administration is successful prior to the election. After the election are we to assume that you will reconsider then those which were more controversial?

Secretary DILLON. I don't think that the House approved things that were just popular. I think they took some hard decisions, and that the decisions they did take represent a substantial advance.

After all, revenue raising reforms or structural changes in the individual tax system will raise over \$1 billion of revenue a year, and that is far more than has been done in that way as far back as our history goes in the income tax system.

It is probably more than all the changes put together.

Senator WILLIAMS. For the record, would you list those increases that total this billion dollars or would you rather supply that for the record?

Secretary DILLON. They are listed clearly in my statement in table 2 of the statement, which shows the rate changes, and then right under that it says, "Structural changes, A, revenue raising," and it lists each one and shows how much they raise, so it is already in the record.

Table 2 is attached to my statement of yesterday.

Senator WILLIAMS. Yesterday in addition to your report I am advised that the chairman put in the record a tabulation that was prepared by the staff which shows about \$1.4 billion increases all together.

Since that is already in the record, we will just let that go.

Secretary DILLON. Fine.

Senator WILLIAMS. You originally asked for more favorable treatment for capital gains, and in part this was presented as I understand it on the grounds that these provisions would serve as a stimulant to the economy.

Now, what has happened in this regard that causes you to think that the economy no longer requires stimulation in this regard? I understand you now are recommending the deletion of that provision which related to capital gains.

Secretary DILLON. Yes, we are. We still think it would be desirable to stimulate the economy in the capital gains area the way we had originally recommended. What we originally recommended was a simplification and a modification of the capital gains laws which would make capital more mobile.

The one element which locks in capital and makes it immobile, freezes it in now, is the fact of the present treatment of capital gains at death, where there is no tax paid on the capital gain property that passes at death, either by the decedent and his estate or by the person who inherits. Therefore, when a person reaches advanced age, not a very advanced age but when they reach an age where they can foresee passing property on to their estate, they are very reluctant and they often feel they can't afford to sell because they can save 25 percent of this value by not selling.

Therefore, we had a combination program which would reduce the rate on capital gains but would increase the holding period from 6 months to a year, which we thought was very logical, because that is the annual accounting period, and would at the same time tax gains at death.

The House felt that the taxation at death was not logical because there wasn't a sale, but they equally said that while there wasn't a sale, there was no reason to step up the basis, and their first decision almost unanimously agreed that there should be a carryover basis at death. This would be similar to the present provision in the law for gifts. So it is not a new idea.

Therefore, on that basis the capital gains would have been taxed at some point. We felt that was reasonably acceptable and that it would have provided this unlocking and this stimulus to the economy.

However, with that provision removed from the bill as it is now, the remaining stimulus to the economy would be very minor from the change in rates from 50 to 40 percent inclusion, and from 25 to 21 percent, and we think that minor stimulation is far outweighed by equity considerations in the fact that there has been no change in this situation allowing complete avoidance of capital gains at death.

So that is the reason for our recommendations.

Senator WILLIAMS. Then as I understand it, you still feel that the House provision on capital gains would represent some minor stimulation to the economy anyway?

Secretary DILLON. It would represent a minor stimulation, I would agree with that, but it is one that we would think would be overbal-

anced by equity considerations. But certainly there would be more capital transactions than there would otherwise be, and therefore capital would flow a little more easily and it would be a minor stimulation. I think it would be minor.

Senator WILLIAMS. What would the revenue effect of the House provision be?

Secretary DILLON. A combination of the House provision—

Senator WILLIAMS. No. I mean as it was passed by the House. Not as you recommended it, but as it was passed by the House what would the revenue effect on the capital gains be?

Secretary DILLON. The revenue effect of that would be varied because there is the first effect of the reduction in rate which would lead to a larger amount of selling than normal.

A number of people would take advantage of that and would sell things that they had not sold before.

Therefore, our estimates—and these are joint estimates by ourselves and the Joint Committee staff—are that the House bill would increase revenues by about \$210 million in the first year, and increase it by \$80 million in the second year, and thereafter there would be a loss of revenue from the House bill, and that that loss would gradually increase until it reached its long-run effect, which would be maybe in 5 years or so, and that would be a loss of \$140 million a year.

So by setting aside this provision which we are recommending, we save the Government \$140 million a year permanently, but we do give up an additional revenue of \$210 million in the first year and \$80 million in the second year.

Senator WILLIAMS. Then do I understand that the administration is today and will in the future be opposed to any reduction in the capital gains treatment unless it is accompanied by a tax on unrealized capital gains at death?

Secretary DILLON. Unless there is some change in the treatment. I think that a carryover of basis provision can be worked out which would be perfectly acceptable and which would justify some change in capital gains treatment generally.

It doesn't necessarily have to be full taxation at death. As long as there is the certainty that there will be taxation, which a carryover basis would give, that would be satisfactory, and I think that can be worked out, because it has worked perfectly well in the gift tax field for many years now.

Senator WILLIAMS. Lest there be a misunderstanding about such income being completely tax free at death, is it not true there is already a tax based on inheritance tax rates of the full value of the security at the time of death? What are those rates on estate taxes under existing law?

Secretary DILLON. What did you say?

Senator WILLIAMS. How high do those inheritance tax rates go under existing law?

Secretary DILLON. With \$10 million estates I think they reach a height of 77 percent under existing law.

I think that it would be fair to say that while the House laid aside this provision on the basis that it was overcomplicated, I think there was also a feeling among many members of the House committee that the estate tax probably needed a new look at some point, and that it



might be more reasonable to make this sort of a change of a carryover basis at death at the time there was a new look at estate tax.

My own feeling is that it is not necessary to wait for that. If that needs to be done, it should be treated as a separate problem, but I think there was a very real feeling there and I think that is one of the reasons that this was deleted from the bill at the last minute.

Senator WILLIAMS. As I understand it, using the example that you mentioned on the estate of \$10 million, it hits the 77-percent bracket. Now, under the administration proposal they would be taxed at the 25-percent capital gains rate on their unrealized income and then the 77 percent would apply on the remainder of the estate after that tax is paid.

In other words, what you are proposing would be a double tax. It would be a 25-percent tax and then 77 percent on the remainder under the administration's proposal; is that correct?

Secretary DILLON. That was the original proposal. The carry-over basis would be a different proposal. There would be only the 77-percent tax, and whatever securities were carried over would maintain their original basis, increased to allow for the inheritance tax that had been paid on the appreciation. This would be a similar provision to that existing in the gift tax area, which has worked very well.

Senator WILLIAMS. And yet the argument has been made—I don't know that you made it, but I saw it appear a time or two—that under the administration's proposal inheritance taxes would be reduced. They would be reduced only by virtue of the fact that there would be another tax put on prior to the computation of the normal inheritance tax, but the net effect of the combination of the administration's proposal, as I understand it, would represent a substantial increase in every single instance, and no one would get reductions; is that correct?

Secretary DILLON. I don't think anyone made a claim—if they did it was wrong—that there would be any reduction in estate tax, in the total tax that is paid.

The whole point of this is to apply to accumulated gains at death, the income tax, the capital gains income tax at some point the same way it is applied to a realized asset.

As you know, if a man now owns a business and sells the business for cash or for securities, or some other way, at the age of 70, for example, he then pays the full capital gains tax on whatever profit he has and pays a full estate tax if he dies a year later, on what is left.

If he doesn't sell it, no capital gains tax is paid by him or his heirs, and that whole income tax area is left free.

That is what we were trying to rectify and what we believe should be rectified.

Senator WILLIAMS. Under the administration's proposal in that connection was there a cutoff period or was it applicable to all assets acquired without regard to the dates of acquisition?

Secretary DILLON. For reasons of simplification, the House proposal, as it was tentatively accepted, did have a cutoff date of, I think it was 1951, and assets acquired prior to that would not have been subject to this provision.

I think the reason for that cutoff period was that they felt that would take care of many older people who had done their estate plan-

ning on the basis of no change. They felt that it would be better to take some sort of a transitional basis. The transitional basis was accomplished by taking that 1951 date, which was an arbitrary date.

Senator WILLIAMS. The administration supported that date as I understand it.

Secretary DILLON. We accepted it.

Senator WILLIAMS. That is approval. That would have the mathematical effect of exempting all of those who had accumulated fortunes by buying securities in the prior war years. They would be exempt from this provision, but all of the young men who are trying to accumulate estates from here on would be subject to the tax, isn't that correct?

Secretary DILLON. No.

Senator WILLIAMS. Why not? All of the large estates that have been accumulated heretofore would all be exempt from such a provision whereas all of the estates created since 1951, and that may be created in the future, would be taxed.

That would be the mathematics of it, would it not?

Secretary DILLON. Not entirely, because it applied to specific securities. I think with all estates there has been a great deal of change in securities from 1951 on.

In fact, it was our estimate that about half of capital gain appreciation in securities that presently exists is in securities that were purchased since 1951.

Senator WILLIAMS. If that is true that defeats your argument that you are trying to tax those securities which normally would not be taxed otherwise. The large fortunes that have already been accumulated would be exempt.

As I understand it, you claimed that this provision was to get some form of capital gains tax on those investments which were passed down from generation to generation without capital gains being paid.

Secretary DILLON. That is correct.

Senator WILLIAMS. Yet those estates were acquired long before the 1951 regime.

Secretary DILLON. Our recommendation was for no cutoff date, and we think that that would be a more complete solution and probably a better solution.

But the House committee thought otherwise and thought they would simplify the matter by having a cutoff date, and we accepted it because we thought it was a substantial improvement in the present situation, but it wasn't everything we wanted.

But legislation is always a question of compromise between the desires in the legislative and recommendations of the executive.

Senator WILLIAMS. Now I want to ask you a question in connection with the investment credit provision.

What were the approximate benefits to American industry under the investment credit provisions of the 1962 act?

Secretary DILLON. Reduction in tax turned out to be about \$1,100 million.

Senator WILLIAMS. \$1.1 billion.

Now in passing that provision last year the Senate approved the so-called Long amendment which had the mathematical effect over a long range of cutting that benefit in half, did it not?

Secretary DILLON. Yes; it cut it roughly in half. Actually, I think you can figure it out mathematically and take the allowance for interest and things of that nature, it reduced it by 45 percent.

Senator WILLIAMS. Close to half.

Secretary DILLON. Yes.

Senator WILLIAMS. So, therefore, under the House bill, I understand with the administration's support, the Long amendment was repealed, that has the effect of doubling the benefits of the investment credit, does it not?

Secretary DILLON. It would roughly double the benefits. That is only one of the reasons for the action that the House took, though. The other other reason, which was very strong, is something which, as I said yesterday, escaped us in the discussions with the Finance Committee.

We had looked on it just as simply as you do now, that this amendment passed last year was merely an amendment reducing the value at something less than half, and naturally we didn't like that but we thought if that was all we could get that would have to be acceptable.

But we discovered in the workings of this that it has made the investment credit far more complex than it needs to be or should be, because it requires double bookkeeping by practically all companies where there is a State income tax.

Practically all States—there may be some exceptions, but the majority of the States do not have the same requirement.

So a company has to set up two sets of books, one with the value of the asset reduced by 7 percent for depreciation purposes for the Federal tax system, and a whole different set of books with the value of the asset at 100 for State purposes, and it has caused all sorts of difficulties.

It has also caused great difficulties in Government contracting, where they have been unable to resolve under cost-plus-fixed-fee contracts what the value of these assets really is. For this reason, many industries and the public accountants have joined together and recommended strongly that this provision be repealed.

Now we did not make this suggestion. We didn't think it was proper, after the Congress had made this decision last year, for us to come in a few months later and say that this decision should be changed. This thing developed in the Ways and Means Committee as a result of testimony by many organizations, and evidence that was developing of the difficulties of handling the credit. So, therefore, they took this action, and we naturally wholeheartedly support it.

Senator WILLIAMS. This complication and the necessity of dual bookkeeping as far as the States are concerned may have been a surprise to the Treasury, but it was not a surprise to some of us on the committee. I called that to the attention of the Treasury Department at the time we passed the bill. Your State is one that is affected.

Many an industry has to run a dual bookkeeping system. At that time the Treasury was not too concerned.

I am glad that you have recognized that there is some problem to this.

But I am not sure it wouldn't have been a better method of correcting it if you repealed it rather than to double it.

But in approving the doubling of this provision you are doing so retroactively, which means, does it not, that industry gets this \$1.2 billion tax deduction retroactively back to beginning in 1963?

Secretary DILLON. No. What was done——

Senator WILLIAMS. Excuse me a moment.

It is retroactive, isn't it?

Secretary DILLON. Yes; but what was done, the House decided to do this. They were faced with this difficult problem. If they did not make this retroactive, it would mean that all assets that had been acquired during this period of 18 months would still require double bookkeeping for the life of those assets.

This seemed a burden that was unnecessary and unwise. Therefore, the House decided to make this retroactive. They did not want a sudden revenue impact as a result of this.

So what they did was to say that the amounts that were deducted from the depreciation base could be added back into the depreciation base as of the 1st of July 1963, and then depreciated as they normally would be over the life of the property, which, over an average of all manufacturing equipment, is 12 years.

This would only lead to a very gradual recovery of this 7 percent that had been taken off for bookkeeping purposes.

Now it is not a handing back of \$1 billion, because the companies, as yet, haven't lost that. They had reduced their depreciable base to \$93, so, therefore, their depreciation, if you say a 10-percent rate of depreciation, was \$9.30 instead of \$10; so they lost 70 cents of deduction. That is all they lost in 1 year. That is all we are talking about adding back on.

Senator WILLIAMS. We are talking about more than 70 cents.

Secretary DILLON. Not on the retroactive part. That is relatively small.

Senator WILLIAMS. That is right; but we are talking about 7 percent on the retroactive.

Secretary DILLON. Oh, yes.

Senator WILLIAMS. And while they cannot claim a refund of this tax which has been paid, but over the life of the machinery——

Secretary DILLON. That is right.

Senator WILLIAMS. Which has been bought, each one will get, retroactively, the full benefits of this \$1,200 million, unless they are fools enough not to take it.

It is there for them to take, under this bill; isn't that correct?

Secretary DILLON. They can increase their depreciation over the life of their property by \$1,200 million.

Senator WILLIAMS. \$1.2 billion, and get that additional benefit under the tax bill.

Secretary DILLON. That is an increase in the depreciation; yes.

Senator WILLIAMS. That is what I was trying to establish.

Secretary DILLON. Not a decrease in taxes.

Senator WILLIAMS. What?

Secretary DILLON. It is not a decrease in taxes. It is an increase in depreciation.

Senator WILLIAMS. It is an increase in depreciation which reduces the tax. Now what is the difference?

Secretary DILLON. Fifty percent comes off the tax.

Senator WILLIAMS. Yes; but they get the tax benefit of the \$1.2 billion. You are doubling the benefits, and I don't want to prolong this, but the Treasury and the staff and all agree—you double it over the life of the machinery; they will recover this.

Secretary DILLON. That is right.

Senator WILLIAMS. And it is recovered to the extent of \$1.2 billion.

Secretary DILLON. No; not in taxes.

Senator WILLIAMS. No; but it would be a depreciable item.

Secretary DILLON. That is right. If we have a 50-percent tax rate, and if you increase depreciation by \$1 billion, you reduce taxes by only \$500 million, so here, by increasing depreciation by \$1 billion roughly, we are, over a long run, reducing taxes by \$500 million.

Senator WILLIAMS. By \$500 to \$600 million, and doing so retroactively. And the bill then will mean that from this day forward industry can depreciate 114 percent of its cost of procuring these items of machinery.

Secretary DILLON. No.

Senator WILLIAMS. That is the mathematics of it.

Secretary DILLON. Well, they would get a 7 percent—

Senator WILLIAMS. Figuring the 50-percent tax rate, they get a 7-percent tax credit.

Secretary DILLON. Immediately?

Senator WILLIAMS. Immediately.

Secretary DILLON. And then they depreciate?

Senator WILLIAMS. That is the equivalent of a 14-percent depreciation, isn't it?

Secretary DILLON. That is right.

Senator WILLIAMS. So the mathematics of it are that under the House bill, as approved by the administration, you will allow industry to write off 114 percent of the cost of their new machinery.

Secretary DILLON. That would be correct.

Senator WILLIAMS. Under the 1962 act, it provided that regulatory ratemaking bodies were authorized to take this investment credit into consideration when they were establishing rates.

This was to insure that the benefits of that reduction went to the consumers.

I understand that while there may have been a controversy, the Treasury so interpreted the intent of Congress.

Now under the House bill, as I read it, not only are these tax benefits doubled, but also the administration has approved another change in the policy, and these benefits under this bill will no longer be passed through to the consumer. Now, is that correct?

Secretary DILLON. No.

Senator WILLIAMS. Are they passed through to the consumer mandatorily, as they were under the old law?

Secretary DILLON. No. As we understand it, they were not passed through to the consumer mandatorily under the old tax either. Our understanding was that we passed a tax bill and then the matter was left to the regulatory agencies as to how they would treat this thing in each case.

There were some problems which developed which were really regulatory problems, and there was a feeling among certain industries, particularly regulated utility industries of one kind or another, that the regulatory agencies were not interpreting the law the way the Congress and the conference committee had decided that it should be. We felt that this was not a matter for us.

The Ways and Means Committee made this change, which they felt was not a change in the original intent of the law. Maybe they are wrong, but their understanding is that what they have written in here is what the original decision was in the conference committee. What they do is they have made, here, a differentiation between those regulated utility companies that Congress gave a 7-percent credit to, and those that Congress gave a three and a half percent credit to.

The ones that they gave the 7-percent credit to are, in effect, the railroad industry.

Senator WILLIAMS. And pipelines.

Secretary DILLON. And pipelines; those two.

Senator WILLIAMS. Yes.

Secretary DILLON. And in the case of both of those, the House felt that the Congress, by differentiating, meant them to be treated differently, and meant that these were not to be passed through to the consumer.

The House so stated it in this amendment.

Now for the rest of the other items, as I understand it they will be passed through and spread over the life of the property to three and a half—

Senator WILLIAMS. To simplify the point though, under the existing law these ratemaking agencies in the case of the railroads and the pipelines are interpreting the law to mean that it must be passed through, and they are taking this into consideration when they make the rates; and that is the reason as I understand it for the House language.

Secretary DILLON. I don't know what has been done by the railroads, but, as I understand it, there has been no decision by any of the ratemaking agencies on just how they were going to do this; they have cases under consideration, and have been taking a lot of evidence. I do not believe they have yet reached a decision, but certainly there were some thoughts that they would do what you say.

Senator WILLIAMS. Sure there is a controversy. If there wasn't there wouldn't be a section in this bill changing it.

Secretary DILLON. I imagine you are correct.

Senator WILLIAMS. Now I would like to quote from page 35 of the staff description of H.R. 8363 as passed by the House of Representatives.

Congress is directing Federal regulatory agencies not to flow this benefit through to the consumer at any time either in the current year or over the useful life of the assets involved.

Secretary DILLON. That has to do with the 7 percent.

Senator WILLIAMS. That is right.

If this bill remains as it is passed and as it is approved by your Department, these ratemaking agencies will not be able to force this flow through to the consumer.

Secretary DILLON. Again, I would like to say that from the point of view of the Treasury, we have no interest and should have no interest in how regulatory agencies handle their own job.

This was something that the Ways and Means Committee felt was desirable to carry out what they thought was the intent of the Congress last year, and we had no reason to object to that if they felt that was the decision of the Congress.

Senator WILLIAMS. As I understand it more specifically—

Secretary DILLON. Again, it was not our recommendation.

Senator WILLIAMS. You earlier told me you were recommending that we approve this bill as it came from the House without any changes, and as it came from the House—

Secretary DILLON. Oh, no.

Senator WILLIAMS. The House bill specifically provides that this cannot be passed through to the consumer except by the consent of the taxpayer himself.

Secretary DILLON. No.

Senator WILLIAMS. And the taxpayer as I understand it under the House bill can elect that it be counted into the ratemaking or he can refuse to let the ratemaking body, but the discretion is solely with the taxpayer under these pipelines and that is who are involved.

Secretary DILLON. Yes; but I would like to make our position perfectly clear. I thought I had. With the exception of capital gains, we have accepted all the provisions in the House bill. We recommend the House bill's approval for reasons of dispatch. That doesn't mean that we will resist changes that this committee might want to make, that could be made relatively rapidly and without too much delay. We fully expect there will be changes. That is what this hearing is all about. That is why we are getting these witnesses, hundreds of witnesses from the public to testify about. That is the purpose of it. We will not take the position that no change can be made in this committee and that we will oppose it. That is not our position at all. All we are saying is that, except for capital gains, we are not recommending any changes in the bill.

Senator WILLIAMS. I appreciate that, and I am glad to get that point clarified.

Now one other section here.

The House bill provides for the repeal of the 4-percent dividend credit.

I understand the administration endorses that proposal: is that correct?

Secretary DILLON. Very strongly.

We recommended that in 1961, and it was put over at that time because the House Ways and Means Committee felt that it should be considered at the time when individual rates were considered as a whole. That time is now, and therefore it was approved at this time. We strongly support it.

Senator WILLIAMS. How do you reconcile the elimination of this tax credit on dividends with your claim that you are trying under this bill to encourage investment and expansion in industry?

Secretary DILLON. Because the dividend credit never encouraged investment and expansion in industry. The record is clear on that. It proved to be merely a means by which high income taxpayers could avoid or could reduce the unduly high rates which they are paying. Now that those rates have been reduced, there is no reason why they should have this special benefit.

Senator WILLIAMS. I noticed your testimony was along that line, but the staff description of the bill shows that all those who receive dividend income, those that are over 65, all those individuals over the age of 65 who are living on dividend income and have an income in excess of \$3,500 but below \$13,000 would get an increase under this bill.

Secretary DILLON. That is not correct.

Senator WILLIAMS. I wish you would straighten that out because the staff claims that that is true.

Secretary DILLON. That is only true if the people have full retirement income credit.

Senator WILLIAMS. At 65; that is right.

Secretary DILLON. No, no; lots of people do not have full retirement income credit.

Senator WILLIAMS. Those over 65 who have the full retirement income credit then—

Secretary DILLON. That is true.

Senator WILLIAMS. That is true?

Secretary DILLON. For individual people, yes.

Senator WILLIAMS. That is right, they get an increase in their taxes.

Secretary DILLON. But they would not—

Senator WILLIAMS. The staff report shows that all those married couples who were over 65 in similar circumstances that have an income between \$7,000 and \$26,000 get the tax increase under this bill. Now, is that true?

Secretary DILLON. I think that is right. I answered that at some length yesterday. I think you were absent.

Senator WILLIAMS. No, I was here.

Secretary DILLON. Well, the point is that actually, if you are a married couple, you do not pay taxes at all if you have full retirement income credit until you have an income of \$6,250, which means that you have about \$200,000 of stock holdings. Thereafter, anywhere above that you would pay somewhat more tax if you neglect to take into consideration the fact of the corporate tax reduction.

Now, the corporate tax reduction will undoubtedly result in an increase in dividend payments. It is not possible to say exactly how much. But if the increase is proportionate to the reduction in the tax, it would be an 8.3-percent increase, which would mean that total dividends received by this elderly family or any of these elderly families would increase and that their total after tax income would increase substantially. So I made the statement yesterday, and I think we can prove it, stand by it, that no elderly person would be hurt or would have less after tax income. They may pay more taxes,



but they would have more after tax income as a result of this bill, even with repeal of the dividend credit.

Senator WILLIAMS. That is only based on your theory that as you reduce corporate taxes, some of it would trickle down. That is this trickle-down theory, is it not?

Secretary DILLON. No, I do not call that a trickle-down theory at all.

Senator WILLIAMS. Under your theory any benefit they get has got to trickle down from the corporation to the stockholders as increased dividends. Is that not what you are saying?

Secretary DILLON. I am saying that corporations are owned by the stockholders.

Senator WILLIAMS. Sure.

Secretary DILLON. Corporations pay dividends to their stockholders, and the record shows that they have paid over the last few years a steadily increasing percentage of their earnings, and that the percentage is relatively constant. They now pay about 60 percent of their earnings to their stockholders if they pay 60 percent of the additional earnings that they get from this corporate reduction over to the stockholders, it would represent an 8.3-percent increase in dividends.

I am not saying that that whole amount will be paid. I am saying it is certain that something will be paid, and I think you can ask any corporate head and they will tell you that their earnings increase and increase steadily, they are going to pay a share of that to their stockholders.

I do not think it is any trickle-down theory that this will happen.

Senator WILLIAMS. I understand that your theory was that these people would have their income increased as a result of increased earnings of corporations.

Secretary DILLON. That is right.

Senator WILLIAMS. It could be some, yes, but this is based on the tax and the earnings as is.

As the staff explains it and as you have confirmed it, all those who are living on income in the category you describe, who are over 65, a single person between \$3,500 and \$13,000, a married couple over 65 between \$7,000 and \$26,000 actually will pay the Federal Government more taxes than they are paying under existing law, and that only those over the \$13,000 and \$26,000 start getting direct reductions in taxes under the administration's bill.

That is true, is it not, that they would only get an increased income as a result of increased dividends in the future, in the hope of some of this corporate tax reduction trickling down?

Now, whether you use that words "trickle down" or not, I did not invent it, it was stated earlier that you could reduce taxes on the corporation on the basis that it trickles down. I was just crediting the New Frontier with coining and putting into use a new theory. I am trying to give you a little credit here for implementing this trickle-down theory.

Secretary DILLON. I am glad of the support from wherever I can get it, but certainly I think it is clear that if corporation profits are higher as they would be, dividends would be higher.

We have to look at the tax bill as a whole. We cannot take a tax bill and take one little piece of it and say because of this little piece everybody will pay more taxes. We have got to look at the tax bill as a whole. The impact of the tax bill as a whole will be that all of these people with whom you are concerned—I think it is right, we are concerned with them too—will have more income to spend as a result of the passage of this bill than they would have without it.

Senator WILLIAMS. Again, only on the basis that the corporations can increase their dividends as a result of reduction in taxes.

As you have just stated, you cannot take part of this bill without looking at the bill as a whole and, looking at the bill as a whole, even though we reduce corporate taxes under the schedule of the House bill, is it not true that for the next 3 to 5 years some corporations will be sending more money to the Federal Treasury as a result of the accelerated payments than they would even under existing law at the 52-percent rate?

Secretary DILLON. No.

Senator WILLIAMS. Their actual cash flow on certain corporations is larger?

Secretary DILLON. No.

Under one of our original proposals it would have been, but under the proposal as adopted by the House in the House bill, they will never pay any more in taxes than they do under present circumstances.

Senator WILLIAMS. But it practically uses up all of these savings in these accelerated payments of these corporations, does it not?

Secretary DILLON. As far as cash flow is concerned, that is correct.

Senator WILLIAMS. I am speaking of cash flow.

Secretary DILLON. That is right.

Senator WILLIAMS. And so, therefore, the corporations for the first few years of this bill in effect will not have the additional cash which you are speaking of to pass on either to the stockholders or anyone else because it goes to the Federal Treasury?

Secretary DILLON. They will have some additional cash because of a change in the basis of assets previously eligible for the investment audit, which will increase their depreciation.

Senator WILLIAMS. That is this new theory which you are advancing and hoping that some of that may trickle down.

Secretary DILLON. But in any event, to be serious, Senator, the great bulk of corporations have very adequate cash resources at this time. The problem of corporations is profitability, not cash flow, and all that would happen would be that, instead of buying Government notes or Government bills, tax anticipation bills which they use to pay taxes 6 months hence, they would be paying the tax now. They would have no real squeeze as far as cash is concerned.

Now there are one or two industries where there are exceptions to this—the steel industry is the big exception where they need all the money they can get for modernization—but I do not think that that would have any effect on the dividend action of corporations.

Senator WILLIAMS. I will not pursue it further. I think we have it clear.

I merely renew my compliments to you again as the first representative of any administration that I know of that has actually tried to put the trickle-down theory into law.

In your statement you state that the administration is supporting H.R. 8363 and that you have chosen the free enterprise private economy course.

By implication, I understand this to indicate that the administration is not following the alternative road of high Government spending. Now, is that correct?

Secretary DILLON. That is correct; for the purpose of reaching full employment as required by the Employment Act of 1946, as I pointed out there are two ways, either substantial additional Government expenditures, which would mean bigger deficits and a bigger Central Government, or reduction in taxes, which would try to stimulate the private economy so it would take up the slack. The latter is what we are trying to do.

Senator WILLIAMS. Now what real evidence, and not just statements, could you supply this committee to show that high Government spending has been abandoned?

In what instances has it been reduced?

Secretary DILLON. I think the answer is, if you want a very simple overall answer, the figures I gave yesterday, which showed that in all areas except defense and space, the spending in the first 3 years of this administration has increased less rapidly than it did during the last administration in its last 3 years. That happens to be a fact which cannot be controverted.

Senator WILLIAMS. Facts are what we would like to have.

I notice that the spending in the last 3 years of the last administration was \$71.3 billion in 1958, \$80.3 billion in 1959, and \$76.5 billion in 1960.

Now in 1961, the first year of this administration, your spending was \$81.5 billion, that is an increase of \$5 billion over 1960; in 1962 it was \$87.7 billion, that is an increase of \$11 billion over 1960, and your projected spending for 1964 is \$98.8 billion, and that will be an increase of \$22 billion over 1960.

Do you have any further comment?

Secretary DILLON. Yes. I do not agree with the years you have taken. I look on 1961 not as the first year of this administration but as the last year of the preceding one, because that budget was recommended in January of 1960. It was voted in 1960. Half of it was fiscal 1961 which was carried through, or 7 months of it was carried through before this administration came in. And, of course, the pattern was set at that time, so the expenditures in 1961 had very little to do with this administration.

Senator WILLIAMS. I will give you all the breaks that you are entitled to. I only took that last year because it was more favorable to you. I will eliminate that one and go back 1 year, to 1957, and that is \$68.9 billion, and that gives an even more unfavorable comparison.

In 1957 it was \$68 billion, or exactly \$26 billion below your current rate of spending, and if you go back another year, you drop \$2 billion more; if you go back another year in the other administration, you drop \$2 billion again.

Secretary DILLON. You mean they were increasing \$2 billion a year as you were going along?

Senator WILLIAMS. Yes; but not \$20 billion.

Secretary DILLON. Well, they made a very big increase in 1959.

Senator WILLIAMS. Increase in the deficit; yes.

Secretary DILLON. And in spending.

Senator WILLIAMS. And in spending too, that is correct. In 1959 spending was \$80 billion or \$18 billion less than today. I think the 1959 rate was too high.

Secretary DILLON. I am not sure they were. I do not. I think they were unwise in hindsight in not at that time following the course which we are recommending now.

Senator WILLIAMS. They jumped spending that year almost half as much as this administration has jumped it in this year. They were half as unwise as maybe you are now.

Secretary DILLON. No. I think if they had followed the course of reducing taxes at that time rather than increasing expenditures sharply, it would have been much more effective, and we would have had a better economy and had a greater likelihood of having balanced budgets much quicker. I think many of the people who were active at that time now regret that they did not follow that course.

The net effect was that the increases in expenditures which were recommended in the winter of 1958 to help that recession never actually took place then. The money did not get into the economy until well into 1959, when we were already past the recession and going up.

So it did not work whereas with a tax reduction the effect takes place immediately, and I think it would have helped that recession. It would have put us in a more comfortable position for the future.

Senator WILLIAMS. Well, I—

Secretary DILLON. But—for instance the economic adviser to the President at that time said his one regret was that they did not do something like we are recommending now at that time instead of increasing expenditures.

Senator WILLIAMS. Well, I do not share that regret. I do not think that the Government, any more than you or I as individuals, can spend itself into prosperity.

Secretary DILLON. I agree with you, Senator, but I do think if we allow our private economy to function freely it will do a lot better job than it has been able to do. It has done a fine job but it can do a far better job and that is what we are trying to allow and I think in that way we feel that we can follow the American tradition of private enterprise and private initiative and that this will lead us toward a balance in our budget faster than any other way I know.

Senator WILLIAMS. Before we leave this subject, just to get the record straight on this spending, since you have brought up the comparison—and I might say I regret very much that under the previous

administration they saw fit to jump spending in 1959 which resulted in that unnecessarily large deficit—I have tabulated here the spending for the 8 years of the Eisenhower administration, and it averaged just slightly less than \$72 billion per year for 8 years.

Using your projected figure for 1964 as submitted in the budget, this administration will have spent \$360.6 billion during its 4 years, or an average of \$90 billion a year.

In other words, during these 4 years spending is running at \$18 billion a year higher than it did in the preceding 8 years, which accounts for the deficits that were experienced.

I want to get the record straight that this administration is not saving money on these programs, but spending today is running \$18 billion a year higher than it did in the preceding 8 years. That is a billion and a half a month, and breaking it down further, that is \$50 million every day this administration is in office you are spending over and above what was spent by the preceding administration. So let's get a comparison straight.

I regret that you have been converted to this spendthrift philosophy, but nevertheless, those are the statistical facts, I took them from the report which you sent to my office this year.

Secretary DILON. I assume the figures are correct, Senator. I would just like to point out that 72 percent of the increases in spending between fiscal 1961 and 1963—and it happens to be the same figure projected into fiscal 1964, the year we are in—were due to increases in defense, space, and interest on the public debt, so that the great bulk of that increase is in the defense field.

There was a difference of policy. Maybe it was a mistake.

I do not think it was. We needed to strengthen our defenses against the threat of the Soviet Union. All I can say is that I felt very happy last fall that we had taken that step 2 years earlier and had the stronger defense that enabled us to have the good result that we had last fall in the Cuban situation.

Senator WILLIAMS. I will not debate the merits or demerits, but nevertheless, that still leaves an increase of \$5 billion a year on the other agencies, and there has been increased spending in every category of this Government that I know of.

Now in 1954 we reduced taxes, which I supported at that time. We reduced taxes by around \$7 billion, if I recall correctly. But in that same year the President reduced spending by \$6 billion, that tax reduction was accompanied by a corresponding reduction in spending, and it did have quite a stimulus on the economy.

I only regret that you are not here recommending a similar curtailment of expenditures along with this tax reduction, and I would say this: that if you were, I would be one of your strongest supporters rather than feeling that we are taking a most unwise step. I just do not see how you can possibly figure to curb the unemployment by creating this lack of confidence of business in the stability of our own economy. I am afraid that is what you are going to do.

Do you know of a single instance in the past history of this country where deficit spending, whether that be caused by increased spending

or tax reduction, where deficit spending has ever relieved the unemployment problem?

Secretary DILLON. I do not think that the question of actual deficits has to do with the unemployment problem. The problem is the question of gross demand. If there is enough demand, we will build up, and our business will operate at capacity and that will relieve unemployment. Certainly as our demand increases, unemployment decreases. Now the theory is that that can be done by stimulating the private economy as we are doing here, or it can be done also by additional Government spending.

It was very clear in the House debate that we have chosen the road of stimulating private enterprise. Let the private sector of our economy carry us through and produce these benefits.

I would like to say a word about 1954 though. In the first place, I made a mistake yesterday when the chairman asked me if this was the first time that a tax cut had been proposed at the time of a deficit. I had forgotten that in 1954 of course there was a deficit and a tax cut was recommended, which increased the deficit temporarily. I think it was a good thing. But that is a precedent.

Now you certainly are correct that there was a reduction in expenditures.

Senator WILLIAMS. That is the point.

Secretary DILLON. At that time, which I would also like to comment on, it just so happened that we had been engaged in a war in Korea which made very heavy defense expenditures necessary. If you will examine reductions that were made in expenditures at that time, you will find that practically all, if not all, were reductions in defense costs which were made possible by the ending of the war. If we had been in a war now and it had ended, we would be delighted to show the same record.

Senator WILLIAMS. Do not tell me you are thinking about another war to cure this problem. The record shows that during the thirties when the unemployment problem was serious an attempt was made to cure the unemployment problem with a longer series of deficits in each of the 6 or 8 years, but the unemployment did not diminish. It stayed with us, and it was not cured until World War II broke out and the men were put in uniform.

I have gone back and assembled statistics as far back as 1900, and I cannot find a single instance where in the years in which we have had deficits, that the unemployment problem has not been higher each year.

Mr. Chairman, I would like to ask that this chart be put in the record. To be honest, I do not know whether it proves that the deficit comes first or the unemployment comes first, but it does show that reducing taxes and creating planned deficits has not cured the problem.

Secretary DILLON. I do not think it shows anything about reducing taxes because we have not tried that before in this connection.

Senator WILLIAMS. That is true. This is the first time I have ever heard of any administration recommending a tax cut financed on borrowed money to reduce unemployment. This is the first.

Secretary DILLON. In the past they have relied on increasing Government expenditures and I think this is new, to rely on the private enterprise system as we are trying to do. I think it is a good decision.

Senator WILLIAMS. Mr. Chairman, I would like for this chart to appear in the record at this point, which shows—I have credited the receipts and expenditures to each administration since 1900 along with the deficits, I have also included in this tabulation a record of when we have increased or decreased taxes, along with the compilation of the national debt.

The CHAIRMAN. Without objection, the chart will be included.  
(The chart referred to follows:)

Year	Administrative budget (in millions of dollars) <sup>1</sup>						Civilian <sup>2</sup> labor force (in millions)			Percent of total labor force unemployed <sup>3</sup>	1st bracket individual tax rates <sup>4</sup>			National debt <sup>5</sup> (billions)	Gross national product in current dollars <sup>6</sup> (billions)
	Receipts	Expenditures	Republicans		Democrats		Total	Em- ployed	Unem- ployed		Increase	Decrease	Percent		
			Surplus	Deficit	Surplus	Deficit									
Republican:															
1901	\$588	\$525	\$63					0.7	2.4				\$1.2		
1902	562	485	77					.8	2.7				1.1		
1903	562	517	45					.8	2.6				1.1		
1904	541	584		\$43				1.4	4.8				1.1		
1905	544	567		23				1.0	3.1				1.1		
1906	595	570	25					.2	.8				1.1		
1907	666	579	87					6	1.8				1.1		
1908	602	659		57				2.9	8.5				1.1		
1909	604	694		89				1.8	5.2				1.1		
1910	676	694		18				2.1	5.9				1.1		
1911	702	691	11					2.2	6.2				1.1		
1912	693	690	3					1.9	5.2				1.1		
Democrat:															
1913	714	715						1.6	4.4				1.1		
1914	725	725						3.1	8.0			1.0	1.1	40.0	
1915	683	746						3.8	9.7			1.0	1.1	40.5	
1916	762	713			\$48			1.9	4.8	Increase		2.0	1.2	48.9	
1917	1,100	1,954						1.9	4.8	do.		2.0	2.9	61.1	
1918	3,630	12,662						.5	1.4	do.		6.0	12.4	77.1	
1919	5,85	18,448						.9	2.3		Decrease	4.0	25.4	84.9	
1920	6,649	6,357			291			1.6	4.0			4.0	24.2	91.9	
Republican:															
1921	5,567	5,058	509					5.0	11.9		Decrease	4.0	23.9	70.3	
1922	4,021	3,285	736					3.2	7.6			4.0	22.9	75.0	
1923	3,849	3,137	713					1.3	3.2		Decrease	3.0	22.3	86.2	
1924	3,853	2,590	963					2.4	5.5		do.	2.0	21.2	85.9	
1925	3,598	2,881	717					1.8	4.0			1.5	20.5	94.5	
1926	3,753	2,883	865					.8	1.9		Decrease	1.5	19.6	98.6	
1927	3,992	2,837	1,155					1.8	4.1			1.5	18.5	96.5	
1928	3,872	2,933	939					2.0	4.4		Decrease	1.5	17.6	98.8	
1929	3,851	3,127	724				49.1	47.6	1.5	3.2		.5	16.9	104.4	
1930	4,058	3,520	738				49.8	45.4	4.3	8.7	Increase	1.5	16.1	91.1	
1931	3,116	3,577		462			50.4	42.4	8.0	15.9		1.5	16.8	76.3	
1932	1,924	4,659		2,735			51.0	38.9	12.0	23.6	Increase	4.0	19.4	58.5	
Democrat:															
1933	1,997	4,598			2,602		51.5	38.7	12.8	24.9		4.0	22.5	56.0	
1934	3,015	6,645			3,530		52.2	40.8	11.3	21.7	Increase	4.0	27.0	65.0	
1935	3,706	6,497			2,791		52.8	42.2	10.6	20.1	do.	4.0	28.7	72.5	
1936	3,937	8,422			4,425		53.4	44.4	9.0	16.9		4.0	33.7	82.7	
1937	4,956	7,733			2,777		54.0	46.3	7.7	14.3		4.0	36.4	90.8	
1938	5,588	6,765			1,177		54.6	44.2	10.3	19.0		4.0	37.1	85.2	
1939	4,979	8,541			3,562		55.2	45.7	9.4	17.2		4.0	40.4	91.1	
1940	5,137	9,053			3,918		55.6	47.5	8.1	14.6	Increase	4.4	42.9	100.6	
1941	7,096	13,255			6,159		55.9	50.3	5.5	9.9	do.	10.0	48.9	125.8	
1942	12,547	34,037			21,490		56.4	53.7	2.6	4.7	do.	19.0	72.4	159.1	



1943	21,947	79,368			57,420	55.5	54.4	1.0	1.9	do		19.0	136.6	192.5
1944	43,563	94,986			51,423	54.6	53.9	.6	1.2	do		23.0	201.0	211.4
1945	44,362	98,303			53,941	53.8	52.8	1.0	1.9		Decrease	23.0	258.6	213.6
1946	39,650	60,326			20,676	57.5	55.2	2.2	3.9			19.0	269.4	210.7
Republican (80th Cong.):														
1947	39,677	38,923	754			60.1	57.8	2.3	3.9			19.0	258.2	234.3
1948	41,375	32,955	8,419			61.4	59.1	2.3	3.8		Decrease	16.6	252.2	259.4
Democrat:														
1949	37,663	39,474			1,811	62.1	58.4	3.6	5.9			16.6	252.7	258.1
1950	36,422	39,544			3,122	63.0	59.7	3.3	5.3	Increase		17.4	257.3	284.6
1951	47,480	43,970		3,510		62.8	60.7	2.0	3.3	do		20.4	255.2	329.0
1952	61,287	65,303			4,017	62.9	61.0	1.9	3.1	do		22.2	259.1	347.0
Republican:														
1953	64,671	74,120		9,449		63.8	61.9	1.8	2.9			22.2	266.0	365.4
1954	64,420	67,537		3,117		64.4	60.8	3.5	5.6		Decrease	20.0	271.2	363.1
1955	60,209	64,389		4,180		65.8	62.9	2.9	4.4			20.0	274.3	397.5
1956	67,850	66,224	1,626			67.5	64.7	2.8	4.2			20.0	272.7	419.2
1957	70,562	68,966	1,596			67.9	65.0	2.9	4.3			20.0	270.5	442.8
1958	68,550	71,369		2,819		68.6	63.9	4.6	6.8			20.0	276.3	444.5
1959	67,915	80,342		12,427		69.3	65.5	3.8	5.5			20.0	284.7	482.7
1960	77,763	76,539	1,224			70.6	66.6	3.9	5.6			20.0	286.3	503.4
Democrat:														
1961	77,659	81,515			3,856	71.6	66.7	4.8	6.7			20.0	288.9	518.7
1962	81,409	87,787			6,378	71.8	67.8	4.0	5.6			20.0	298.2	553.9
1963	86,400	92,600			6,200	75.1	70.8	4.3	5.7			20.0	304.8	
1964	86,900	88,802			11,902							20.0	315.6	
Total			21,999	35,419	3,849	296,888								
Less sur- pluses				21,999		3,849								
Cumulative deficits each party				13,420		293,039								

<sup>1</sup> Budget, fiscal year ending June 30, 1964, p. 422.

<sup>2</sup> 1901 through 1928, p. 215 of "The Measurement and Behavior of Unemployment," by National Bureau of Economic Research, Princeton University Press. 1929 through 1946, p. 206 of "Statistical Abstract of United States, 1959." 1947 through 1963, U.S. Department of Labor, Bureau of Labor Statistics.

<sup>3</sup> Joint Committee on Internal Revenue Taxation.

<sup>4</sup> Budget, fiscal year ending June 30, 1964—p. 422.

<sup>5</sup> Facts and figures on Government expense, 1962-63, Tax Foundation, p. 49

<sup>6</sup> First enacted.

<sup>7</sup> Less than \$500,000.

<sup>8</sup> July 1963.

<sup>9</sup> Estimate.

NOTE.—Variations in totals result from rounded figures.

Source: Statistics assembled by John J. Williams, U.S. Senate, September 1963.

Senator WILLIAMS. Yesterday you made the statement that although the economy is growing, it is doing so in a cyclical fashion.

Now, does that imply that in your view we will have a recession if this tax cut is not enacted?

Secretary DILLON. Yes, although I do not know exactly when.

Senator WILLIAMS. If this tax bill is enacted, does that mean that you do not think we would have a recession and you are confident that our problems as far as a recession is concerned would all be over?

Secretary DILLON. Not all over forever, but I think that the situation would be such that we would have every opportunity of emulating and doing what has been the case in Europe for the last 7 or 8 years where their growth is cyclical too, but it never reaches the point of recession. They just grow slightly less rapidly one year than they do another year.

I think that there is no reason why we cannot do as well as other advanced industrialized countries, and I think that by giving private industry its head this way, with this sort of a tax cut, that we would, as the President put it, probably skip a recession, and we would be in a much stronger position. We might not have the types of recessions that we have had since the war.

I must say that, because of social security and various legislation, such as unemployment insurance, they have been much more moderate than the great depressions that characterized earlier years when the Government took no action at all. So I think we can continue on that pattern and improve it. The way to do it is to pass this tax bill.

Senator WILLIAMS. Suppose this tax bill is enacted, and the unemployment still persists, what steps are you going to recommend then?

Secretary DILLON. I do not think this tax bill is the whole answer to unemployment either. There are a substantial number of other attacks. This is a very complicated problem, and other attacks are presently under way, which are supported not only by the administration, but by the Congress. These include better vocational training, and measures to give greater mobility to labor. In this last connection, one of the particular things which this bill accomplishes, through the moving expense deduction, is to help labor move from places without jobs to places with jobs.

We will have to do a lot of that sort of work, a great deal more than we have done in educational and training work, and reeducation of workers for new jobs. But I think this would be the main effort. The big impetus would be given by this tax bill.

Senator WILLIAMS. Then you really do not know whether you would advocate another tax cut or increased spending if this project does not work?

Secretary DILLON. No, I do not think either would be necessary.

Senator WILLIAMS. At the moment, assuming that you get this bill, as I understand it, you are recommending this as an alternative to increased spending in new fields; is that correct?

Secretary DILLON. That would be the only other alternative, to try to handle this unemployment problem.

Senator WILLIAMS. Now, based on that answer—

Secretary DILLON. It is an alternative we do not like.

Senator WILLIAMS. I noticed that the House today is holding hearings on H.R. 7351. That is the accelerated public works bill. Now

that bill would authorize \$800 million in new funds for accelerated public works.

What is the administration's position on that bill?

Secretary DILLON. That is not an administration bill.

Senator WILLIAMS. I understand that, but does the administration oppose that bill or do you recommend it?

Secretary DILLON. We do not recommend it. We have not been asked what our position is on it. Hearings are being held in the appropriate committee, and if they wish to find the administration position I suppose they can.

Senator WILLIAMS. I understood that hearings were being held and that the administration had not been asked, and I did not want you slighted, so I am asking you now—as far as you are concerned your position would be opposed to the enactment of that bill; is that correct?

Secretary DILLON. At this particular moment, at this particular time, I do not think that bill is necessary.

Senator WILLIAMS. Do you know whether that coincides with the Budget Director's views?

Secretary DILLON. No.

Senator WILLIAMS. Or should we ask him when he comes in?

Secretary DILLON. You can ask him if you wish.

The answer is, this is not an administration bill and there has been no administration position on it.

Senator WILLIAMS. I appreciate that. That is the reason I was asking for your position.

Secretary DILLON. I think he would probably say he does not know. This just happens to be a case of a committee exercising its right as a committee, to hold hearings, and it is holding them.

Senator WILLIAMS. In your description as to the budgetary impact of this bill, when did you indicate that you think the budget would be balanced, assuming the enactment of this bill?

I think you covered that yesterday.

Secretary DILLON. I said that the first time it could be, with good fortune, in fiscal 1967, and it might be delayed until fiscal 1968. But it is in that area when we would expect to reach budget balance.

Senator WILLIAMS. Dates have a way of connecting themselves with election intervals. Does that mean that if this administration continues in office, there is no hope of a balanced budget should this administration be reelected?

Secretary DILLON. No, because the last date, which I think is quite certain, is 1968, there would be a balanced budget in the year ending in June of 1968. There would presumably be also a balanced budget underway for the fiscal year 1969, which would also be part of this administration if it is continued in office, and it would be their responsibility. So I would say there would be two or three balanced budgets out of eight that they were responsible for.

Senator WILLIAMS. I thought that in your earlier statement you said that an incoming administration had no responsibility for the budget, which ended June 30 of that year because you objected to—

Secretary DILLON. That is quite right. That is just what I am saying now. Therefore, it is the outgoing administration, which would be this one, that would have the responsibility for the fiscal 1969 budget rather than the new administration, whatever it might be, that came in in January 1969.

Senator WILLIAMS. Just to give each administration its own credit, when this administration came in the budget that had been submitted, was a balanced budget for fiscal year 1962. This was submitted by the preceding administration, to the Congress as a balanced budget. So we will have to charge this deficit entirely to this administration, the first year's deficit.

Secretary DILLON. The one in 1962, I think—

Senator WILLIAMS. And 1961.

Secretary DILLON. I think we had obvious time to change. I do not think the balanced budget that was submitted, looked at in hindsight, was realistic. The revenue estimates turned out to be much higher than the revenues actually collected. There would have been a deficit anyway. But I do not think that that is anything worth arguing about, because I think in 1962 the full responsibility rests with this administration, fiscal 1962.

Senator WILLIAMS. Is the administration fully satisfied with the changes which this bill makes in connection with the oil depletion or do you recommend that we do something further?

Secretary DILLON. No, we are not fully satisfied at all. We made a further recommendation, but after a long discussion this was turned down. It was turned down by a very substantial vote of the House Ways and Means Committee, 3 or 4 to 1, and so I see no possibility of our recommendations being accepted and going in the bill, so we are not making any suggestions that that be reopened. But we thought it was a good suggestion at the time and we still do.

Senator WILLIAMS. Some of us are naturally born optimists.

Would you submit to this committee a draft of your recommendations so the committee could consider them in our deliberations? I mean the draft of the language.

Secretary DILLON. We never made any language draft because, as you know, the Constitution provides that tax bills originate in the House of Representatives, and the House of Representatives in any major income tax bill asks us not to submit language, and the language is all drafted in the House itself by its own drafters, so we never had any language on this.

Senator WILLIAMS. The Constitution also provides that the Senate can consider amendments?

Secretary DILLON. Yes.

Senator WILLIAMS. And upon our request you can furnish suggested language for such an amendment?

Secretary DILLON. That is correct.

Senator WILLIAMS. So will you furnish that?

Secretary DILLON. If you request that, we would be glad to furnish language to you for whatever use you want to make of it that would carry out the recommendations we originally made. But we want to make it clear that we think that it would be a waste of time to get into detailed consideration of this particular problem at this time. We regret that it would be a waste of time, but since it is, we are not pressing this. But if you ask us to do it, we will of course furnish you with whatever you ask.

Senator LONG. I would like to ask what is the requirement that the Treasury draft the language?

We have got a good staff here of our own and we have our own legislative drafting service. We pay these people and they are good.

Why do we have to have the Treasury draft the language for us? It is purely a policy decision.

Senator WILLIAMS. I have no objections to the Senator from Louisiana drafting it if he knows what Treasury has recommended.

I have read your statement, but I just thought that if you drafted it in the bill, it would be clearly in order. Now, whether the Treasury or in conjunction with the staff drafts it, but rather than somebody else trying to draft the language and say this is what the Treasury recommends—you have on other occasions I know submitted to us suggested language. I do not think you object to doing this, do you?

Secretary DILLON. It is extra work. What we have done is available. We could very easily, without a great deal of additional work, we could provide for the record here the appropriate appendix, detailed technical explanation to the suggestion which we made to the House which describes this thing in great detail. It is not legislative language, but it is perfectly clear for anyone who wants to read it as to exactly what it means, because it is a technical detailed description.

I am sure you probably have not had a chance to see that. But that does describe in great detail exactly what is involved.

Senator WILLIAMS. I have seen your statement. I am not an attorney and much of this language is as clear as mud until you analyze its application.

Secretary DILLON. Legislative language would be less clear.

Senator WILLIAMS. That is what I mean by asking you to draft the legislative language. All I am asking is that you cooperate with our staff, and whether the staff drafts it or you draft it, I am not concerned. But I would like to see it in printed form, we would then be able to submit it as "this is what the Secretary wants."

Secretary DILLON. If that is what your wish is and if that is the committee's wish, we will be glad to collaborate with the staff of the committee and see if we can put that particular recommendation into legislative language.

Senator SMATHERS. Mr. Chairman, may I just say this: I think the Secretary has tried to make it clear that at this time he is not recommending any change in this particular item. I would hope the Senator from Delaware would not thereafter try to make it appear that because the Treasury Department submitted some language that this per se becomes an automatic recommendation.

I think the Secretary has tried to make it very clear that we have got a staff upon which we always rely. I agree with the chairman completely, but what will happen is this: the Senator from Delaware will say this is the administration position.

I understand from what the Secretary says that that is no longer the position at the present time with respect to this particular bill.

Senator WILLIAMS. Is that true?

Have you withdrawn your support of that provision?

Secretary DILLON. As I think Senator Smathers made the point perfectly clear, that with respect to this particular bill we feel that it would be a waste of time. As I said earlier, we feel that is unfortunate. We think it was a good suggestion, but it was fully debated in the Ways and Means Committee. We made every effort we could to get it adopted. We were able to persuade maybe a quarter of the members of that committee, and three-quarters were opposed to it.

So we realistically feel that there is no possibility of getting that particular suggestion enacted.

In view of the great importance of passing this bill, we see no sense in wasting a lot of time, going through waste motions, on this subject. So we are not recommending that this be added to this bill at this time.

Senator WILLIAMS. I was just trying to expedite the consideration of the bill. I thought this would do it, but it may take me a little longer to get that drafted without your cooperation. Then we will submit it to your Department to see if that is what you recommend and I will await your answer along with your suggested changes.

Now, what was the vote in the House on including the capital gains provision?

Was it not an overwhelming vote likewise?

Secretary DILLON. Including the present provision?

Senator WILLIAMS. The capital gains provisions of this present bill.

Secretary DILLON. Oh, yes; but it was originally included at the same time that other provisions regarding carryover of basis were also included. When the carryover was left out, there was a change in our position. The Treasury favored all the original changes. The administration favored them. There was almost a unanimous vote in favor of them in the Ways and Means Committee.

Senator WILLIAMS. Yet you are not reluctant to ask us to strike out the provision of a section which was almost unanimously approved by the House? You are not afraid of that, but you are fearful of any tampering with the rates as it relates to the oil industry.

I wonder what is the difference. Why is one sacred and the other is not?

Secretary DILLON. I found out last year in certain parts of the bill before this committee that it is very easy to strike out a provision. You make a motion to strike, and if you have enough votes that is that. You do not need any discussion, which is what occurred with one of the important elements of last year's bill. Therefore, we do not think this would be any delay whatsoever, whereas to talk about and argue the merits of including something that is not included is a totally different thing that can result in a great deal of delay, all for no purpose.

Senator WILLIAMS. As I understand it, you are willing for us to strike out of this bill one section?

Secretary DILLON. We are recommending it, not merely willing.

Senator WILLIAMS. Recommending that we strike out, but you are recommending that we confine our activities to strikeouts and not additions to this bill?

Secretary DILLON. No; I made that very clear. This committee can do whatever it wishes. All I am saying is that we are not urging the committee to do anything else except make this one change in the bill by striking out a section. That does not mean that there may not be changes that this committee can make in this bill that may bring it nearer in line with our original suggestions that we would be very happy about. But we are not picking and choosing between them, and urging the committee to do any of them.

Senator WILLIAMS. Do you think the present 27½ percent depletion on oil is realistic or should it be adjusted downward?

Secretary DILLON. We have studied that matter at some length. We probably have not studied it enough. I do not know how to study it enough.

The problem is that there is no way of proving that any particular percentage of depletion is adequate or too much or inadequate. Twenty-seven and a half percent is certainly very generous. That is our view. But if you try to find a better figure, I do not know what it is.

However, on a related point, we felt the law was working in a way which nullified the 50-percent limitation of existing law for the determination of the depletion deduction. It was our suggestion to change that. We were unsuccessful.

That is the one you were talking about. But we are not recommending any basic change in depletion allowances which would involve all materials that are presently covered. It would not be confined just to oil and gas. Certainly that would delay this bill forever. We are not making any such recommendations at this time.

Senator WILLIAMS. I do not quite understand why it would delay it forever if we could make up our minds how we want to act on it.

I read your recommendations in connection with this depletion allowance and while they may not have gone quite as far as some of us would like, at least they were a step. That is the reason that I was asking that it be reduced to printed form, unless you have withdrawn your support from it.

Maybe we could at least take that step. I was hoping that we could get those recommendations in written form.

Secretary DILLON. I think it is worth noting that for the first time, I think, since the history of the income tax, this bill does provide a section which will increase rather than decrease taxes on the oil and gas industry, and that was approved by the House, and I think that is quite a step forward.

Senator WILLIAMS. And that was approved by the industry, and the assumption is we let it go.

Secretary DILLON. I hope the industry will approve it. It costs them \$40 million more in taxes, and I think they should approve it. I think it is fair, but I do not know that they have approved it.

Senator WILLIAMS. Now before I close, I have a question which has nothing to do with this bill, but you made a recommendation about a month and a half or 2 months ago to tax foreign investments. What is the status of that bill and are you going to continue your support or request for action?

I have not heard anything on it. What is the status?

Secretary DILLON. The bill is in the Ways and Means Committee. Public hearings have been held. Executive sessions have not yet started. When the Senate Finance Committee finishes with their testimony from me, they will start. They were ready to start this week, but in view of the fact that the Finance Committee was working on this bill, and should have had and did have priority, they were postponed for a week when they assumed that I would be free and able to testify. Executive sessions will begin next week.

Senator WILLIAMS. When that bill gets over, will you ask us to lay this bill aside and consider that bill?

Secretary DILLON. No.

Senator WILLIAMS. You want us to hold that bill over here until after this one has been disposed of?

Secretary DILLON. I think nothing should be done to delay this bill. That was the President's recommendation. The House therefore did not allow it to delay its consideration of the major bill. It was able to fit it in during a period of time when drafting was underway on H.R. 8363, this tax reduction bill. They were able to fit in a week of public hearings without delaying the major bill.

If there is a possibility of doing that, if it can be done without delay on this bill, of course that would be fine. But we feel it is so important to get this bill enacted this year that we are not asking for anything which may upset that priority. But we would ask the very prompt consideration of the interest equalization bill thereafter.

Senator WILLIAMS. I am not debating this point.

Secretary DILLON. Yes.

Senator WILLIAMS. I am just trying to get information.

Secretary DILLON. Yes.

Senator WILLIAMS. Because I have had several people in to see me about this, and they are very much concerned because, as it stands now, as I understand it, the Treasury Department has issued forms for those buying these securities with which they must comply. You did put an effective date presumably of July 15, is it not?

Secretary DILLON. The date which we have recommended that the legislation be effective is July 18, the date of the President's message.

Senator WILLIAMS. You have forms which the Treasury Department has submitted to the brokerage companies to have signed by these purchasers?

Secretary DILLON. That is quite correct. Since we recommended that date, we wanted to facilitate the observance of this by the financial community, should it become law, so it would be practical, and we did make available such forms and they are being used and the financial community is operating under this system with no problem.

Senator WILLIAMS. Are they collecting the tax on this, or are they just merely holding it as an obligation?

Secretary DILLON. Oh, no; you cannot collect the tax.

Senator WILLIAMS. I know but—

Secretary DILLON. Until the Congress levies it, so no tax is being collected.

Senator WILLIAMS. How do they carry the tax? They will be liable for it?

Secretary DILLON. The bill provides that the first tax that one is liable for would be payable, I think, 30 days after the enactment of the bill by the Congress.

Senator WILLIAMS. But it is payable on purchases made back to last July?

Secretary DILLON. That is right.

Senator WILLIAMS. So in effect, all of the formality of putting the law into effect has been gone through—the writing of the forms—a law which has not been passed by either session of the Congress is being implemented.

I am wondering about the wisdom of such action if the bill should not either be enacted or rejected. At least a decision should be made in order that they would know where they stand. That is the com-



plaint that I am getting, not either exactly for the bill or against the bill, just asking that the confusion be eliminated.

Secretary DILLON. I think that is a reasonable request. The problem, as the chairman has pointed out, is that the very important bill before this committee takes a lot of time to consider. It has, unfortunately, delayed the other bill. If it had not been for this, we would have hoped that it could have been enacted by both Houses within a month, just as quickly as possible.

There was no other way to make a recommendation. With our balance-of-payment situation as it was we could not have made a recommendation for a prospective tax, or we would have had a perfect flood of foreign borrowings in this country which would have swamped us. So the only possible approach was to state that after today you cannot borrow without this tax. We could not say that after a year or 6 months from now you cannot borrow without the tax or we would have been literally swamped. We are not very happy about the effect of it, but we will do the best we can. That is all I can say.

Senator WILLIAMS. As I understand it, if this pending bill gets deadlocked either in the Senate or in the Senate behind the parliamentary situation, which is not under the control of this committee, it is then your recommendation that this other bill ride in back of this one even though it means going over until next year?

Secretary DILLON. While the interest equalization bill may have some inconvenience for a few investors in foreign securities, it is nowhere near equivalent in importance to the mass of the American people as the broad tax bill which you are now considering. Therefore, you should not delay this tax reduction bill.

Senator WILLIAMS. As I said, I am not debating the merits.

Secretary DILLON. No.

Senator WILLIAMS. Nor am I trying to put that bill on a par with this one.

Secretary DILLON. No.

Senator WILLIAMS. In importance of consideration.

Secretary DILLON. Surely.

Senator WILLIAMS. I am questioning, though, as to the wisdom of the Treasury projecting a date which would have been proper at the time, but then letting the enactment of the measure drift for 6 or 8 months.

Secretary DILLON. We have not let it drift.

Senator WILLIAMS. But it has had that effect of drifting.

Secretary DILLON. It has had that effect, but we regret it as much as you do.

Senator WILLIAMS. It has been drifting and postponed upon your recommendation to the Ways and Means Committee that they give this bill priority. Now you are recommending that we in turn give this bill priority.

Secretary DILLON. That is right.

Senator WILLIAMS. I am not quarreling with your decision. I am merely trying to set the record that this is your decision.

Secretary DILLON. That is correct.

Senator WILLIAMS. As to why this other bill is not being considered prior to this particular time and any disposition made of it.

Secretary DILLON. That is correct.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Chairman, may I say that Senator Anderson of New Mexico asked me to state he had been present for an hour and 32 minutes while the Senator from Delaware was asking questions and was unable to ask questions as a result of the long interrogation by the Senator from Delaware. He requested me to ask that his rights be reserved at a future session.

Mr. Secretary, you are a very courteous and competent witness. It is always a pleasure to welcome you here. I have here in my hand a table which I understand was issued by your Office of Tax Analysis on July 24, 1962, showing that in the year 1959 there were 5 taxpayers with incomes over \$5 million, pardon me, with adjusted gross incomes of over \$5 million, who did not pay one single cent in taxes; that there were 10 with adjusted gross incomes between \$1 and \$5 million who did not pay a single cent; there were 5 with adjusted gross incomes between \$500,000 and \$1 million, who did not pay a single cent.

May I ask if the table which I have in my hand is authentic and whether these facts are correct?

Secretary DILLON. Yes. I recall those tables. There was a series of tables.

Senator DOUGLAS. May I ask that the tables as of April 11, 1963, marked "Table 1," "Table 1 of July 24, 1962," "Table 1-A of July 24, 1962," "Table 2 of July 24, 1962," "Table 2-A of July 24, 1962," "Table 3 of July 24, 1962," "Table 4 of July 24, 1962," and "Table 5 of July 24, 1962," be made a part of the record at this point?

The CHAIRMAN. Without objection.

(The tables referred to follow:)

TABLE 1.—April 11, 1963: Effective tax rates based on adjusted gross income and amended adjusted gross income for all taxable returns, 1960

[Dollars in millions]

Adjusted gross income	Number of returns (thousands)	Adjusted gross income	Excluded net long-term capital gains	Amended adjusted gross income	Tax after credits	Tax as percent of adjusted gross income	Tax as percent of amended adjusted gross income
Up to \$5,000.....	22,751.0	\$69,141	\$423	\$69,564	\$6,274	9.1	9.0
\$5,000-\$10,000.....	19,998.0	138,455	789	139,244	15,362	11.1	11.0
\$10,000-\$20,000.....	4,422.0	56,128	933	57,060	8,448	15.0	14.8
\$20,000-\$50,000.....	764.0	21,901	1,001	22,902	4,993	22.8	21.8
\$50,000-\$100,000.....	101.0	6,648	652	7,300	2,273	34.2	31.1
\$100,000-\$150,000.....	14.0	1,688	283	1,971	681	40.3	34.6
\$150,000-\$200,000.....	4.0	750	170	920	320	42.6	34.7
\$200,000-\$500,000.....	5.0	1,370	451	1,821	607	44.3	33.3
\$500,000-\$1,000,000.....	.7	486	240	726	226	46.4	31.1
\$1,000,000 and over.....	.3	584	285	869	281	47.8	32.3
Total.....	48,061.0	297,151	5,226	302,377	39,464	13.3	13.0

Source: 1960 Statistics of Income.

#### NOTES

A. Those with incomes of \$5,000,000 and over pay half as much tax, proportionately, as those with  $\frac{1}{10}$  as much income (roughly).

B. Two-thirds of the average multimillionaire's income is taxed at the 25-percent rate—little more than the 1st-bracket rate.

Explanation:

Total income (with all capital gains): \$9,000,000.

Total capital gains (\$3,100,000 included and \$3,100,000 excluded on tax return): \$6,200,000.

Put another way, for the average multimillionaire, more than \$3,000,000 of income is wholly untaxed—doesn't even appear on p. 1 of his tax return.

C. Average multimillionaire has not only \$3,000,000 of capital gains excluded from his taxable income—he also has \$3,000,000 of deductions (business plus personal, presumably), so he is taxed on only  $\frac{1}{3}$  of his total income.

TABLE 1.—July 24, 1962: Average income, excluded capital gains, and total deductions by amended gross income classes; all returns with \$500,000 or more adjusted gross income, 1959

	All returns <sup>2</sup>	Amended gross income <sup>1</sup>				
		\$500,000- \$749,999	\$750,000- \$999,999	\$1,000,000- \$1,999,999	\$2,000,000- \$4,999,999	\$5,000,000 or over
Number of returns.....	1,002	190	239	401	180	37
Average amended gross income.....	\$1,574,918	\$621,500	\$879,607	\$1,336,219	\$2,932,692	\$8,954,243
Average excluded capital gains.....	\$488,825	\$36,568	\$213,188	\$455,292	\$1,033,154	\$3,140,892
Average adjusted gross income.....	\$1,086,093	\$584,932	\$666,419	\$880,927	\$1,899,538	\$5,813,351
Average total deductions.....	\$315,672	\$159,379	\$177,749	\$198,868	\$415,969	\$2,918,595
Excluded capital gains as percentage of amended gross income.....	45.0	6.2	32.0	51.7	54.4	54.0
Deductions as percentage of amended gross income.....	31.0	5.9	24.2	34.1	35.2	35.1
Deductions as percentage of adjusted gross income.....	29.1	27.2	26.7	22.6	21.9	50.2
Total capital gains as percentage of amended gross income.....	62.0	11.8	48.4	68.2	70.4	70.2
Median effective tax rate <sup>3</sup> .....	27.6	53.0	28.6	23.8	24.6	23.7

<sup>1</sup> Adjusted gross income amended for each return to include, in full, capital gains and losses realized in 1959 and exclude capital loss carryover from the preceding 5 years.

<sup>2</sup> Includes 1 return with negative amended gross income and 4 returns with amended gross income between \$250,000 and \$500,000 not shown in detail.

<sup>3</sup> Tax paid expressed as a percentage of amended gross income.

NOTE.—Except for the median effective tax rate shown, all percentages on the table are derived from the aggregate dollar amounts for each income class. The result will differ from the one obtained by computing the average of the ratios for each return.

TABLE 1-A.—July 24, 1962: Number of returns by effective tax rates based on adjusted gross income by income classes; all returns with adjusted gross income of \$500,000 or more, 1959

Adjusted gross income	Total	Effective tax rate (percent)									
		0	0.1 to 9.9	10 to 19.9	20 to 29.9	30 to 39.9	40 to 49.9	50 to 59.9	60 to 69.9	70 to 79.9	80 to 84.9
\$500,000 to \$749,999.....	529	3	4	6	34	90	241	73	47	27	4
\$750,000 to \$999,999.....	193	2	3	3	9	23	90	36	16	9	2
\$1,000,000 to \$1,999,999.....	197	8	1	1	8	22	93	34	17	12	1
\$2,000,000 to \$4,999,999.....	64	2	-----	-----	4	6	21	9	6	5	1
\$5,000,000 and over.....	19	5	-----	-----	-----	1	6	3	3	1	-----
All returns.....	1,002	20	8	10	55	142	461	155	89	54	8

TABLE 2.—July 24, 1962: Percentage distribution of effective tax rates based on adjusted gross income by income classes; all returns with adjusted gross income of \$500,000 or more, 1959

[In percent]

Adjusted gross income	Median	Total	Effective tax rate (percent)									
			0	0.1 to 9.9	10 to 19.9	20 to 29.9	30 to 39.9	40 to 49.9	50 to 59.9	60 to 69.9	70 to 79.9	80 to 84.9
\$500,000 to \$749,999.....	46.0	100	0.6	0.8	1.1	6.4	17.0	45.6	13.8	8.8	5.1	0.8
\$750,000 to \$999,999.....	47.5	100	1.0	1.6	1.6	4.7	11.9	46.6	18.7	8.3	4.6	1.0
\$1,000,000 to \$1,999,999.....	48.8	100	4.0	.5	.5	4.1	11.2	47.2	17.3	8.6	6.1	.5
\$2,000,000 to \$4,999,999.....	47.3	109	3.1	-----	-----	6.3	9.4	48.4	14.1	9.4	7.8	1.5
\$5,000,000 and over.....	46.8	100	26.3	-----	-----	-----	5.3	31.6	15.8	15.8	5.2	-----
All returns.....	46.6	100	2.0	.8	1.0	5.4	14.2	46.0	15.5	8.9	5.4	.8

NOTE.—See table A1 for number of cases represented.

TABLE 2-A.—July 24, 1962: Number of returns by effective tax rates based on amended gross income by income classes; all returns with adjusted gross income of \$500,000 or more, 1959

Amended gross income <sup>1</sup>	Total	Effective tax rate (percent)									
		0	0.1 to 9.9	10 to 19.9	20 to 29.9	30 to 39.9	40 to 49.9	50 to 59.9	60 to 69.9	70 to 79.9	80 to 84.9
No amended gross income.....	1	1									
\$250,000 to \$499,999.....	4	1	1		1	1		1			
\$500,000 to \$749,999.....	190	1	3	1	17	24	32	50	35	24	3
\$750,000 to \$999,999.....	239	1	2	28	100	29	27	22	19	8	3
\$1,000,000 to \$1,999,999.....	401	9	3	21	261	27	23	28	16	12	1
\$2,000,000 to \$4,999,999.....	130	2	1	8	90	5	7	5	8	4	
\$5,000,000 or over.....	37	6		1	22		2	2	3	1	
All returns.....	1,002	20	10	59	491	86	91	108	81	49	7

<sup>1</sup> Adjusted gross income amended for each return to include in full capital gains and losses realized in 1959 and exclude capital loss carryover from the preceding 5 years.

TABLE 3.—Percentage distribution of effective tax rates based on amended gross income by income classes; all returns with adjusted gross income of \$500,000 or more, 1959

[In percent]

Amended gross income <sup>1</sup>	Median	Total	Effective tax rate (percent)									
			0	0.1 to 9.9	10 to 19.9	20 to 29.9	30 to 39.9	40 to 49.9	50 to 59.9	60 to 69.9	70 to 79.9	80 to 84.9
No amended gross income.....		100	100.0									
\$250,000 to \$499,999.....	32.4	100		25.0		25.0	25.0		25.0			
\$500,000 to \$749,999.....	53.0	100	.5	1.5	0.5	8.9	12.6	16.9	26.4	18.4	12.7	1.6
\$750,000 to \$999,999.....	28.6	100	.4	.8	11.7	41.9	12.2	11.3	9.2	7.9	3.3	1.3
\$1,000,000 to \$1,999,999.....	23.8	100	2.3	.8	5.3	65.1	6.7	5.7	6.9	4.0	2.9	.3
\$2,000,000 to \$4,999,999.....	24.6	100	1.5	.8	6.2	69.2	3.9	5.4	3.8	6.1	3.1	
\$5,000,000 or over.....	23.7	100	16.2		2.8	59.4		5.4	5.4	8.1	2.7	
All returns.....	27.6	100	2.0	.9	5.9	49.0	8.6	9.1	10.8	8.1	4.9	.7

<sup>1</sup> Adjusted gross income amended for each return to include in full capital gains and losses realized in 1959 and exclude capital loss carryover from the preceding 5 years.

NOTE.—See table A2 for number of cases represented.

TABLE 4.—July 24, 1962: Median and range of effective tax rates by amended gross income classes; all returns with \$500,000 or more adjusted gross income, 1959

[In percent]

	All returns <sup>1</sup>	Amended gross income <sup>2</sup>					
		\$250,000 to \$499,999	\$500,000 to \$749,999	\$750,000 to \$999,999	\$1,000,000 to \$1,999,999	\$2,000,000 to \$4,999,999	\$5,000,000 or over
Median effective tax rate.....	27.6	32.4	53.0	28.6	23.8	24.6	23.7
Proportion of returns with effective tax rate less than 30 percent.....	57.8	50.0	11.4	54.8	73.5	77.7	78.4
Proportion of returns with effective tax rate of 60 percent or higher.....	13.7	0	32.7	12.5	7.2	9.2	10.8
Number of returns.....	1,002	4	190	239	401	130	37

<sup>1</sup> Includes 1 return with negative amended gross income not shown in detail.

<sup>2</sup> Adjusted gross income amended for each return to include in full capital gains and losses realized in 1959 and exclude capital loss carryover from the preceding 5 years.

TABLE 5.—July 24, 1962: Median and range of effective deduction rates by amended gross income classes; all returns with \$500,000 or more adjusted gross income, 1959

[In percent]

	All returns <sup>1</sup>	Amended gross income <sup>2</sup>					
		\$250,000 to \$499,999	\$500,000 to \$749,999	\$750,000 to \$999,999	\$1,000,000 to \$1,999,999	\$2,000,000 to \$4,999,999	\$5,000,000 or over
Median effective deduction rate.....	13.9	60.2	24.4	18.7	8.6	7.6	11.6
Proportion of returns with effective deduction rate less than 20 percent.....	61.4	0	40.0	53.6	73.1	73.0	59.5
Proportion of returns with effective deduction rate 40 percent or higher.....	9.2	75.0	15.3	8.3	6.2	9.9	21.6
Number of returns.....	1,002	4	190	239	401	130	37

<sup>1</sup> Includes 1 return with negative amended gross income not shown in detail.

<sup>2</sup> Adjusted gross income amended for each return to include in full capital gains and losses realized in 1959 and exclude capital loss carryover from the preceding 5 years.

Senator DOUGLAS. Now Mr. Secretary, I find these figures shocking. Here are 20 men with adjusted gross incomes of over half a million dollars a year who paid no taxes, 5 with incomes of over \$5 million who paid no taxes. It is true, I believe, that the adjusted gross income does not include deductions for intangible drilling and developmental costs. Am I correct in that?

Secretary DILLON. I think so.

I would like to say about this that one of the provisions which we recommended and which was not adopted by the House would have rectified this situation as far as those with very high income are concerned. Most of these individuals take advantage of the present provision in the law allowing them to get a full deduction for gifts to charity, and they give away securities equivalent to their full income regularly every year. We felt that while this was a very good thing probably for charity, because most of these people give them to good charities, nevertheless, that everybody, just as a moral principle, should pay taxes. That was left out. That is the main reason.

Senator DOUGLAS. I do want the record to be clear, however, that adjusted gross income does not include deductions for intangible drilling and developmental costs.

Secretary DILLON. That is correct.

Senator DOUGLAS. Am I also clear that this adjusted gross income does not include interest on State and municipal bonds?

Secretary DILLON. That is correct.

Senator DOUGLAS. That is, these items are income which these people receive but which are not counted even as income and hence are tax exempt?

Secretary DILLON. That is right.

Senator DOUGLAS. The same thing is true of intangible drilling and developmental costs?

Secretary DILLON. That is right.

Senator DOUGLAS. Mr. Secretary, I find these figures shocking. If you take an average wage earner, let us say, with wages of \$100 a week, his sole income, or \$5,200 a year, he would pay taxes on approximately \$2,280 if he has a wife and two children, and with the standard deductions he would pay taxes on \$2,280, or would pay, according to my figures, approximately \$456 in taxes.

Secretary DILLON. Under the present law.

Senator DOUGLAS. Yes.

Now then, is the percentage of evasion or avoidance high among wage earners?

Secretary DILLON. No, I do not think it is.

Senator DOUGLAS. There is a compulsory withholding tax?

Secretary DILLON. A withholding tax, yes.

Senator DOUGLAS. And as I remember it, there is only a 1- or 2-percent avoidance or evasion.

Now Mr. Secretary, this is the basic unfairness in the tax structure which has caused many of us to feel that reform is as imperative as reduction.

When you have a situation of people with over \$5 million of gross income, well over \$5 million, paying no taxes whatsoever, and the average wage earner pays a tax of about \$460, this is grossly unfair and is a reflection upon the tax laws of the country. It may be legal,

it probably is legal, but it certainly is an indication that there is a need for closing what we have referred to as loopholes, but which I think may better be described as truck holes.

Secretary DILLON. Certainly, Senator, on these very large ones, I think the ones who pay no taxes at all are perhaps individuals who have this special right on charitable contributions, which we felt should be eliminated, and recommended be eliminated. But the House, on consideration, did not do it because of the representations from the various universities and institutions that were getting the benefit of this.

Senator DOUGLAS. I have analyzed the figures on your table 1 of July 24. It appears there that the 37 individuals with total incomes over \$5 million, each had, as an average, approximately \$3,140 million of capital gains which never entered into the figure of adjusted gross income, that is one-half of their total capital gains.

Secretary DILLON. That is the 50 percent, yes, sir.

Senator DOUGLAS. Then the capital gains included amounted to that figure?

Secretary DILLON. The same amount, yes.

Senator DOUGLAS. That is right, so that on average total income, including all capital gains, of \$8,954 million, taxes were paid on only about a third of this figure. When you consider \$3,140,000 of excluded capital gains and nearly \$3 million of other deductions.

I refer now to the 37 individuals with more than \$5 million total income. Now there are the big truck holes which enable the people with these enormous incomes to completely avoid taxation. You mentioned charitable gifts.

Secretary DILLON. To completely avoid it.

Senator DOUGLAS. That is one, but what about the capital gains?

Secretary DILLON. Capital gains, they do not completely avoid it but they have, as I say, a rate of 25 percent.

Senator DOUGLAS. Yes.

Secretary DILLON. No higher than 25 percent.

Senator DOUGLAS. And half of all capital gains is completely excluded from income and the maximum capital gains rate is 25 percent, is that not true?

Secretary DILLON. It is the total tax of 25 percent. The remainder is taxed at 50 percent, so it is a 25 percent rate.

Senator DOUGLAS. Is it not a common device of the capital gains tax to disguise ordinary income as capital gains?

Secretary DILLON. I think that there has been a good deal of that, but when we looked at this for the figure, and that was studied very carefully, we found that in value it was not as large as we had expected. This comes in the timber industry in particular, and certain things of that nature.

Senator DOUGLAS. Let me pursue that a little further.

Is not the lower rate of capital gains the incentive behind the stock option provision of corporations?

Secretary DILLON. Oh, certainly.

Senator DOUGLAS. To disguise what is really an increase in income as a capital gain, is that not true?

Secretary DILLON. Certainly it makes a capital gain that could be an addition to income, and we think there is a lot of that in it. That



was the reason that we recommended that stock option provisions be repealed at the same time we made our recommendations that the top rate go down to 65 percent. That was not done in the House because there was a lot of testimony that pointed out that there was some advantage in getting executives to own stock in the corporation, and I think there probably is some advantage from that point of view if they keep their stockholdings.

So, therefore, they changed, tightened up so that people who received this could not just turn around and sell it in 6 months, as many of them had done, but had to keep it for a long time.

Senator DOUGLAS. This truck hole was not closed in large part?

Secretary DILLON. In large part.

Senator DOUGLAS. Now you recommended that capital gains on treatment of livestock be repealed. That was not done.

Secretary DILLON. That was not done, but it was not a significant amount of dollars.

Senator DOUGLAS. You recommended that the capital gains on timber be repealed, and that was not done.

Secretary DILLON. Again, that was not done, but it was not significant in dollar amounts.

Senator DOUGLAS. And you recommended repeal of the capital gains tax for the distribution of lump-sum benefits.

Secretary DILLON. That was not done. That, I think, is more important compared to the others, a more important hole.

Senator DOUGLAS. And, as I say, you recommended repeal of capital gains for stock options. This was not done?

Secretary DILLON. Yes.

Senator DOUGLAS. Although some restrictions were placed in the bill?

Secretary DILLON. Yes.

Senator DOUGLAS. Now, the House went even further, did it not? It extended capital gains treatment to iron ore?

Secretary DILLON. Yes, it did that over the objection of the Treasury.

Senator DOUGLAS. You came out of the House in a worse situation than you went in, so far as capital gains were concerned?

Secretary DILLON. The revenue loss was \$5 million on iron ore.

Senator DOUGLAS. My good friend from Delaware has referred to the depletion allowances.

Secretary DILLON. I would like to correct myself. We did not come out worse than we went in because we picked up \$15 million on the capital gains treatment of real estate, so that was a little better.

Senator DOUGLAS. Before I leave capital gains, to come to the crucial point, as I understand it, you were willing to reduce the rate of capital gains taxation if you could levy a capital gains tax upon transfer of property at death; is that correct?

Secretary DILLON. That is correct.

Senator DOUGLAS. You offered a quid for a quo?

Secretary DILLON. That is right.

Senator DOUGLAS. Now they took the quid from you. What quo did they give?

Secretary DILLON. We did not get a quo. So that is why we are asking that that provision be stricken.

Senator DOUGLAS. Now, suppose this body does not strike the provision. Would you recommend that the President veto the bill?

Secretary DILLON. Senator, I do not think I could, in good conscience, because I think the major effects of this bill are so important, and after all the efforts that have been put into it for reducing rates and helping to stimulate the economy, that even though I would not like this provision and would so indicate to the President, I do not think that that would be such as to say that on balance the whole effort should be returned again to the Congress with a veto.

Senator DOUGLAS. Mr. Secretary, this is a very serious point. The President started back in 1961 with a dual program of tax reduction and tax reform. It is now 1963, almost 1964. There has been precious little reform. There was \$2.5 billion of tax reductions last year for corporations in the form of higher depreciation and the investment credit, but very little reform.

What has progressively happened has been that the reform elements which you propose, and I think they were rather timid, I may say, have been progressively eliminated, and I think they have been eliminated in large part because the members of the legislative bodies and the special interests who throng these hearing halls and who call upon Senators and Congressmen, have the impression that you are so anxious for a tax cut that you can throw all these away and nothing will happen, so that by not presenting a virile position, not having a virile stance in favor of the tax reform, you have permitted the tax reform features to be progressively gutted.

Now I think what you have just said is a further invitation to get the reforms. You are, in effect, saying to the Senate, if you stand on the House position, even though there is no reciprocity even in the field of capital gains, the bill will not be vetoed. Is that not a real invitation to the special interests that are here to push for maintenance of the House language, knowing that they will not suffer any punishment if this is done?

Secretary DILLON. I would hope the Finance Committee would not succumb to any such pressure. I would like to say that this is very difficult. We have certainly tried just as hard as we could, both last year and this year, to get a substantial number of structural changes, reforms that we thought were equitable, which would raise revenue.

The net total of last year and this year's effort, taking what is in the House bill, is to increase revenue through reforms of about \$1.9 billion. We have looked back, did a little research, to see what had ever been done before in the way of tightening up the income tax on this type of thing, and the total we could find was something like \$600 million altogether before, so in 2 or 3 years we have done three times as much.

I think it is not enough; I am not satisfied, but it is a start, and I think we are moving in the right direction. I think it is a significant start if we raise that much money.

Senator DOUGLAS. Table 2 in the appendix of your statement indicates that \$520 million of this is the deduction of personal taxes and \$110 million exclusion of sick pay. Those are primarily deductions made from the incomes of lower income people rather than upper income people.

Secretary DILLON. They apply across the board.

Senator DOUGLAS. I would say that the reforms which you have been able to put through, assuming they are reforms, with the exception of the elimination of the 4-percent dividend credit, have been primarily reforms which have affected the lower income groups but which have not hit the upper income groups.

Secretary DILLON. I would say the expense account provisions last year were different.

Senator DOUGLAS. Which?

Secretary DILLON. The expense account provisions.

Senator DOUGLAS. I am somewhat curious as to what the practical effect of that expense account has been. I think it is a good deal of much ado about nothing.

Now Mr. Secretary, another big source of deductions is not only the intangible drilling and developmental costs which never entered into adjusted gross income at all, but which, according to figures on pages 317 and 318 of your testimony before the House amounted to a total of approximately, according to my figures, \$2.1 billion for domestic concerns and \$500 million for foreign concerns. There is \$2.6 billion there.

Secretary DILLON. That is mostly in the corporate field, of course.

Senator DOUGLAS. I understand. But corporations are primarily owned by the upper income groups.

Secretary DILLON. That is quite correct.

Senator DOUGLAS. Now, on page 302 of your testimony before the House, you state that the total minerals depletion allowance for corporations, doing 86 percent of the business, was \$2.8 billion; assuming that the 14 percent is not quite in proportion, do you not think a conservative estimate would be that \$3 billion is deducted because of the depletion allowances?

Secretary DILLON. I would say that is the amount of the depletion allowance.

Senator DOUGLAS. \$3 billion, and of this, \$2.2 billion is deducted in the oil industry, oil and gas industry.

Here we have two tremendous loopholes, capital gains, and oil depletion as well as the intangible drilling and developmental costs for oil.

Is not the important thing to try to remove these favors, and remove them for everybody? When we remove them for everybody, then we could lower the upper rate of taxation.

I would be ready to concede that the upper rate should come down from 91 to possibly 60 percent, provided you sweep all these away for everybody, not merely for those who choose to do it.

Now if I may go on to certain other elements, on the oil depletion allowance you originally asked for four rather cumbersome changes which would have netted about \$250 million.

Secretary DILLON. That was our original estimate.

Senator DOUGLAS. Yes.

Secretary DILLON. But later we found we had overestimated, and those four changes would probably actually net about \$185 million.

Senator DOUGLAS. And you came out with one of the four, three of them being turned down. The total increase in revenue is \$40 million?

Secretary DILLON. Yes.

Senator DOUGLAS. And we have estimated that the total amount of deduction for depletion is \$3 billion, and the normal tax at 52 percent would be roughly \$1.5 billion, so you have reduced the special privilege by  $2\frac{2}{3}$  percent.

Secretary DILLON. It is a small percentage.

Senator DOUGLAS. A very small percentage.

Now you use some interesting language in referring to jumbo insurance for high income executives in your statement. As I remember, the jumbo was the term applied by Phinneas T. Barnum to an elephant he bought from southeast Asia for his circus. It was the largest elephant in captivity, and the term "jumbo" therefore became synonymous with hugeness: whether my friend from Delaware believes the elephant should be called jumbo or not, I do not know.

Senator WILLIAMS. He is a very important animal and I think he should.

Senator DOUGLAS. In any event, it is ordinarily interpreted to mean huge size.

Now, you did not have any detailed exhibits on these alleged jumbo insurance policies. Without identifying the individuals, you must have had some examples to go upon. Would you produce for the record at this point some of the examples, preserving the anonymity of the gentlemen in question by designating them as X, Y, and Z, or possibly A, B, C, D, E, F, and so on?

Secretary DILLON. We will try to. I do not know how much of that type of information we have because it is not fully available on tax returns. Just as an example, we are aware of one case where an individual had an insurance policy, a group term insurance policy, life insurance policy that was tax free this way, of \$900,000.

(The following was later received for the record:)

APPLICATION OF PERSONAL HOLDING COMPANY PROPOSALS OF THE HOUSE BILL TO NINE CASES

SUMMARY

The nine examples contained herein illustrate how individuals have adjusted the sources of gross income of their closely held corporations so as to avoid having them classified as personal holding companies. Cases I, III, IV, V, VII, VIII, and IX arranged operations so that rents of the corporations constituted 50 percent or more of their gross income. Cases II and VI arranged operations so that 20 percent or more of the corporations' gross income came from the operation of a business. Case IV shows a double arrangement to avoid personal holding company classification. In the first 2 years reviewed, capital gains from the sale on an installment basis of the machinery and equipment of the corporation constituted more than 20 percent of the gross income of the corporation. However, after the installment payments were concluded in 1959, the rental income next year constituted over 50 percent of gross income.

The fact that 7 out of the 10 avoidance cases (case IV being counted as two cases) used rents as an avoidance device is not surprising. Capital gains from the sale of capital assets other than securities or commodity futures represent a source of income that is available in relatively unique circumstances. Active business operations can be subject to many types of problems which may cause losses. As a matter of fact, the corporation in case II reported losses from its business operations in both years reviewed herein. On the other hand, rental property is available in all areas, has been used as an investment medium for centuries, provides acceptable security for loans, and offers relatively little risk over a short period of time if the property has a record of acceptable earning power.

The table on the following page summarizes the results of the nine case studies by showing the additional personal income tax that the nine individuals would have had to pay if they had to take into their personal income the equivalent of the undistributed personal holding company income of their closely held investment companies. While none of these companies were classified as personal holding companies under present law,<sup>1</sup> all would have been so classified under the House bill.

*Increase in the income tax of nine individuals that would have taken place if the personal holding company proposals in the House bill had been in effect in the past years<sup>1</sup>*

Case	Year	Taxable income		Income tax		Increase in income tax	
		Present law	Proposal	Present law	Proposal	Amount	Percent
I.....	1960	\$40,441	\$47,760	\$13,400	\$16,760	\$3,354	25
II.....	1960	110,971	181,105	54,672	113,987	59,315	108
III.....	1961	113,369	208,423	48,253	113,229	64,976	135
IV.....	1960	44,395	58,161	16,886	24,642	7,756	46
V.....	1959	68,549	140,618	27,493	75,535	48,092	175
VI.....	1960	68,080	175,120	28,915	101,685	72,750	252
VII.....	1961	24,842	42,929	6,643	14,918	8,275	125
VIII.....	1960	77,183	89,180	39,997	48,502	8,525	21
IX.....	1960	66,299	83,618	23,948	32,906	8,958	37

<sup>1</sup> The examples all assume that all the corporate income classified as undistributed personal holding company income under the House bill would have been taxed to the stockholder in proportion to his ownership of the corporation rather than to the corporation.

The table shows that the use of closely held investment companies to avoid personal income tax is not limited to the very rich. Three of the individuals reported taxable incomes under present law of less than \$50,000, and only two had taxable incomes under present law of over \$100,000. The amount of individual income tax avoided also is not necessarily large in aggregate terms. In five cases it was less than \$10,000. In relative terms, the tax avoided was a minimum of 21 percent of actual tax and ranged up to 250 percent.

The fact that some of the individuals in the case studies had only moderately large incomes is not unexpected in view of the difference in the tax treatment of dividends at the corporate and individual level. Since the maximum corporate rate on dividends is 7.8 percent and the individual rate on dividends falling in the first bracket is 16 percent,<sup>2</sup> every taxable individual recipient of dividends could save tax on his dividends if he could arrange to have them taxed only at the corporate level. The only reason why so many dividend recipients take their dividends directly into their own income is their wish for current income and the corporate costs, risks, and additional capital needed to set up an investment company which does not fall within the concept of a personal holding company.

#### *Case I: Year 1960*

Corporation Z was incorporated in 1959. All but 2 percent of the stock is owned by one person. He obtained his stock in corporation Z in exchange for shares of an established dividend-paying corporation. If the stockholder had retained the dividend-paying stock he transferred to the corporation, his individual income tax rates on the dividends therefrom in 1960 would have been 56 and 59 percent, these being the rates on taxable income of \$40,000 to \$52,000 in the case of a married person. Shortly after incorporation, the corporation purchased a parcel of real estate through the use of borrowed funds. Rents constituted 71 percent of gross income in the first year of operation. If, as is proposed by the House bill, rents had been measured as net after interest, real estate taxes, and depreciation, they would have been negative. The corporation would then

<sup>1</sup> One company was classified as a personal holding company in I, but not all, of the years reviewed.

<sup>2</sup> Under the House bill the figures for 1965 would be 7.2 percent and 14 percent, respectively.

have been considered a personal holding company because all of its adjusted ordinary gross income would have come from dividends and interest.

The computed undistributed personal holding company income of corporation Z was nearly \$7,500. Adding this sum as dividend income to the owner of the corporation would have increased the individual's income tax from about \$13,500 to nearly \$17,000.

*Case I*

	Present law, 1960		Proposal, 1960	
	Amount	Percent distribution	Amount	Percent distribution
<b>Corporation Z:</b>				
Gross income (total).....	\$33,174	100.0	\$9,469	100.0
Personal holding company income (total).....	9,469	28.6	9,469	100.0
Dividends.....	9,350	28.2	9,350	98.7
Interest.....	119	.4	119	1.3
Gains from securities and commodity futures.....				
Rents, under 60 percent of gross income.....			<sup>2</sup> (1,763)	
Income from personal service contracts.....				
Nonpersonal holding company income (total).....	23,705	71.4		
Gains from sale of other capital assets.....				
Rents, 50 percent or more of gross income.....	23,705	71.4		
Other.....				
Taxable income <sup>1</sup> .....	7,468		7,468	
Corporate income tax.....	0		0	
Dividends.....	0		0	
Undistributed personal holding company income.....	0		7,468	
<b>Individual taxpayer, 98 percent owner of corporation:</b>				
Taxable income.....	40,441		47,760	
Individual income tax.....	13,406		16,760	
Increase in individual income tax.....			3,354	25

<sup>1</sup> For the "Proposal" column, the figure is "adjusted ordinary gross income."

<sup>2</sup> Not included in total.

<sup>3</sup> Before dividend received deduction.

*Case II: Years 1959 and 1960*

Corporations X and Y were incorporated on the same date in 1959. They paid no dividends in 1959 and 1960. They are both 100 percent owned by one person. He obtained their stock by an exchange of shares of an established dividend-paying corporation. If the taxpayer had retained the stock transferred to the corporations, his marginal rates of individual income tax on the dividends from this stock would have ranged from 50 to 69 percent in 1959 when he filed a joint return, and from 75 to 89 percent in 1960 when he filed as a single person. In addition to holding the stock paid in, corporations X and Y invested in several partnerships operating varied businesses. Part of the partnership interests were paid for with borrowed funds. The corporations' proportionate shares of the gross receipts of the partnerships were included in the gross income of the corporations. Since the partnership receipts constituted about 25 percent of the gross income of the corporations, the corporations were not classified as personal holding companies. Under the proposed revision of the law, the corporations would have been classified as personal holding companies because over 60 percent of their adjusted ordinary gross income was personal holding company income (i.e., dividends).

If the corporations had been classified as personal holding companies and the computed undistributed personal holding company income (\$27,000 in 1959 and \$74,000 in 1960) considered as having been distributed as a dividend to their sole stockholder, the stockholder's personal income tax would have been increased by about \$18,000 in 1959 and \$59,500 in 1960. His actual individual income tax was about \$75,500 in 1959 and \$54,500 in 1960.

Case II

	Present law, 1959				Present law, 1960				Proposal, 1959				Proposal, 1960			
	Corporation X		Corporation Y		Corporation X		Corporation Y		Corporation X		Corporation Y		Corporation X		Corporation Y	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
<b>Corporations X and Y:</b>																
Gross income (total) <sup>1</sup> .....	\$20,945	100.0	\$35,058	100.0	\$37,462	100.0	\$64,962	100.0	\$20,945	100.0	\$35,058	100.0	\$37,462	100.0	\$64,962	100.0
Personal holding company income (total).....	15,750	75.2	26,250	74.9	27,563	73.6	45,938	70.7	15,750	75.2	26,250	74.9	27,563	73.6	45,938	70.7
Dividends.....	15,750	75.2	26,250	74.9	27,563	73.6	45,938	70.7	15,750	75.2	26,250	74.9	27,563	73.6	45,938	70.7
Interest.....																
Gains from securities and commodity futures.....																
Rents, under 50 percent of gross income.....																
Income from personal service contracts.....																
Nonpersonal holding company income (total).....	5,195	24.8	8,808	25.1	9,899	26.4	19,024	29.3	5,195	24.8	8,808	25.1	9,899	26.4	19,024	29.3
Gains from sale of other capital assets.....																
Rents, 50 percent or more of gross income.....																
Other.....	5,195	24.8	8,808	25.1	9,899	26.4	19,024	29.3	5,195	24.8	8,808	25.1	9,899	26.4	19,024	29.3
Taxable income <sup>2</sup> .....	10,720		18,176		27,867		48,439		10,720		18,176		27,867		48,439	
Corporate income tax.....	482		818		555		1,617		482		818		555		1,617	
Dividends.....	0		0		0		0		0		0		0		0	
Undistributed personal holding company income.....	0		0		0		0		10,103		17,126		27,312		46,822	
	Individual—Amount				Individual—Amount				Individual				Individual			
									Amount		Percent		Amount		Percent	
Individual taxpayer, 10 percent owner of corporation:																
Taxable income.....	159,763				110,971				186,962				185,105			
Individual income tax.....	75,364				54,672				93,478				113,987			
Increase in individual income tax.....									18,114		24		59,315		10	

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."

<sup>2</sup> Before dividend received deduction.

*Case III: Years 1959, 1960, and 1961*

Corporation W was incorporated in 1955. It paid no dividends in 1959, 1960, or 1961. The corporation is entirely owned by one person. Corporation W's income was derived entirely from dividends, capital gains, and rents. Gross rents were over 50 percent of gross income in all years, so it was not classified as a personal holding company. Even if rents had been computed net of real estate taxes, interest, and depreciation, corporation W would not have been classified as a personal holding company. Rental income would still have been over 50 percent of the adjusted ordinary gross income of the corporation in all years. However, income from other types of personal holding company income (in this case dividends) was more than 10 percent of the ordinary gross income. Thus, rental income would have been considered personal holding company income as a result of this revised test in the House bill. All of the adjusted ordinary gross income of the corporation being from dividends and rents, the corporation then would have been considered a personal holding company in 1959, 1960, and 1961.

The addition of the reconstructed, undistributed personal holding company income (\$104,500 in 1959, \$83,500 in 1960, and \$95,000 in 1961) as a dividend to the stockholder's income would have increased the latter's reported personal income tax from \$51,000 to \$118,500 in 1959, from \$39,000 to \$86,000 in 1960, and from \$48,500 to \$113,000 in 1961.



## Case III

	Present law, 1959		Present law, 1960		Present law, 1961		Proposal, 1959		Proposal, 1960		Proposal, 1961	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Corporation W:												
Gross income (total) <sup>1</sup> .....	\$356,241	100.0	\$363,178	100.0	\$408,798	100.0	\$219,113	100.0	\$210,941	100.0	\$236,252	100.0
Personal holding company income (total)....	122,322	34.3	105,333	29.0	146,657	35.7	219,113	100.0	210,941	100.0	236,252	100.0
Dividends.....	105,152	29.5	75,813	20.9	89,531	21.9	105,152	48.0	75,813	35.9	89,531	37.9
Interest.....												
Gains from securities and commodity futures.....	17,170	4.8	29,520	8.1	56,526	13.8						
Rents, under 50 percent of gross income <sup>2</sup> .....							113,961	52.0	135,128	64.1	146,721	62.1
Income from personal service contracts.....												
Nonpersonal holding company income (total).....	233,919	65.7	257,845	71.0	262,741	64.3						
Gains from sale of other capital assets.....												
Rents, 50 percent or more of gross income.....	233,919	65.7	257,845	71.0	262,741	64.3						
Other.....												
Taxable income <sup>3</sup> .....	128,496		121,715		161,386		128,496		121,715		161,386	
Corporate income tax.....	11,027		16,312		23,819		11,027		16,312		23,819	
Dividends.....	0		0		0		0		0		0	
Undistributed personal holding company income.....	0		0		0		104,392		83,263		95,054	
Individual taxpayer, 100 percent owner of corporation:												
Taxable income.....	121,526		95,380		113,369		225,918		178,643		208,423	
Individual income tax.....	50,927		38,771		48,253		118,596		86,191		113,229	
Increase in individual income tax.....							67,659	133.0	47,420	122.0	64,976	135.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."

<sup>2</sup> Under the proposal, rents constituting any proportion of adjusted ordinary gross income would be treated as personal holding company income if personal holding company

income (other than rental income) constitutes more than 10 percent of ordinary gross income.

<sup>3</sup> Before dividend-received deduction.

*Case IV: Years 1958, 1959, and 1960*

Corporation V is owned by one person. During the years in question, the corporation paid no dividends. Originally it operated as a manufacturing concern. In 1955 it disposed of its machinery and equipment in an installment sale, with payments running through 1959. The assets were then invested in securities and real estate. In 1958, rents were less than 50 percent of gross income and thus constituted personal holding company income. However, the gain on the installment sale of machinery and equipment was 43 percent of gross income. The corporation thus did not fall into the category of a personal holding company. The corporation would have been considered a personal holding company under the proposal to exclude capital gains, and to deduct real estate taxes, depreciation, and interest from rents, in computing adjusted ordinary gross income. Rents as recomputed would have constituted 49.6 percent of adjusted ordinary gross income. Undistributed personal holding company income of \$8,000, if added to the income of the sole stockholder as a dividend, would have increased his individual income tax from about \$14,000 to \$18,500.

In 1959, corporation V reported 39 percent of its gross income as gain from the installment sale of its machinery. It would not have been classified as a personal holding company under the proposal merely because adjusted ordinary gross income for personal holding company purposes would be computed by excluding capital gains, and after deducting interest, real estate taxes, and depreciation from gross rents. Under the suggested revision, rents still would have constituted 52.9 percent of adjusted ordinary gross income. However, dividends and interest were over 40 percent of ordinary gross income. Therefore, the rental income would have been classified as personal holding company income under the proposed 10-percent test. Undistributed personal holding company income would have been about \$12,500. Since the stockholder's individual income tax return for this year is not available, it is not possible to compute the additional tax that he would have had to pay if this \$12,500 were considered a dividend to him. However, judging by the income shown on the stockholder's 1958 and 1960 returns, he would have been taxed on the \$12,500 at a rate higher than 50 percent.

In 1960, corporation V no longer had any installment gains. All income was from dividends, interest, rents, and capital gains on securities. It was not classified as a personal holding company under the terms of the existing law, however, because 51.5 percent of the gross income was from rents. But, under the proposed recomputation of rental income and personal holding company income, it would have been considered a personal holding company, even though rental income still made up 54.5 percent of adjusted ordinary gross income. Dividends and interest again represented over 40 percent of ordinary gross income. The addition of the undistributed personal holding company income of nearly \$14,000 of corporation V as a dividend to the reported income of the stockholder would have raised his marginal individual income tax rate from 59 to 62 percent. His tax would have been increased from nearly \$17,000 to about \$24,500.

Case IV

	Present law, 1958		Present, law 1959		Present law, 1960		Proposal, 1958		Proposal, 1959		Proposal, 1960	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Corporation V:												
Gross income (total) <sup>1</sup> .....	\$42,965	100.0	\$47,074	100.0	\$34,986	100.0	\$21,226	100.0	\$24,648	100.0	\$27,553	100.0
Personal holding company income (total).....	24,600	57.3	28,709	61.0	16,973	48.5	21,226	100.0	24,648	100.0	27,549	100.0
Dividends.....	4,285	10.0	7,649	16.3	8,614	24.6	4,285	20.2	7,649	31.0	8,614	31.3
Interest.....	6,401	14.9	3,976	8.4	3,919	11.2	6,401	30.2	3,976	16.1	3,919	14.2
Gains from securities and commodity futures.....	414	1.0	1,084	2.3	4,440	12.7						
Rents, under 50 percent of gross income <sup>2</sup> .....	13,500	31.4	16,000	34.0			10,540	49.6	13,023	52.9	15,007	54.5
Income from personal service contracts.....												
Nonpersonal holding company income (total).....	18,364	42.7	18,364	39.0	18,013	51.5						
Gains from sale of other capital assets.....	18,364	42.7	18,364	39.0								
Rents, 50 percent or more of gross income.....					18,000	51.5					13	( <sup>3</sup> )
Other.....					13	( <sup>3</sup> )						
Taxable income <sup>4</sup> .....	28,505		32,868		21,133		28,505		32,868		21,130	
Corporate income tax.....	6,625		7,153		4,034		6,625		7,153		4,034	
Dividends.....	0		0		0		0		0		0	
Undistributed personal holding company income.....	0		0		0		8,078		12,674		13,766	
Individual taxpayer, 100 percent owner of corporation:												
Taxable income.....	39,553		( <sup>5</sup> )		44,395		47,628		( <sup>5</sup> )		58,161	
Individual income tax.....	14,225				16,886		18,514				24,642	
Increase in individual income tax.....							4,289	30.0			7,756	46.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."

<sup>2</sup> Under the proposal, rents constituting any proportion of adjusted ordinary gross income would be treated as personal holding company income if personal holding company income (other than rental income) constitutes more than 10 percent of ordinary gross income.

<sup>3</sup> Negligible.

<sup>4</sup> Before dividend received deduction.

<sup>5</sup> Not available.

*Case V: Year 1959*

Corporation U was incorporated in 1955. It paid a small cash dividend in 1959. The corporation is owned in equal parts by two persons who are officers of a manufacturing concern. Over two-thirds of the assets of corporation U consist of the dividend-paying stock of the manufacturing concern. The only other income source of any significance of corporation U is real estate which is carried in part with borrowed funds. In 1959 corporation U was not classified as a personal holding company because 50.4 percent of its gross income was from rents. All other income was derived from dividends and interest. Revision of the measurement of rents, as proposed, would have resulted in its reclassification as a personal holding company because only 31 percent of adjusted ordinary gross income would have been deemed to be derived from rents. Attribution of half of the undistributed personal holding company income of corporation U as a dividend of \$72,000 to stockholder A would have increased the stockholder's marginal tax rate from 62 to 78 percent and his tax from \$27,500 to \$75,500.

*Case V*

	Present law, 1959		Proposal, 1959	
	Amount	Percent distribution	Amount	Percent distribution
<b>Corporation U:</b>				
Gross income (total) <sup>1</sup> .....	\$286,797	100.0	\$207,440	100.0
Personal holding company income (total).....	142,173	49.6	207,440	100.0
Dividends.....	136,351	47.6	136,351	65.7
Interest.....	5,822	2.0	5,822	2.8
(Gains from securities and commodity futures).....				
Rents, under 50 percent of gross income.....			65,267	31.5
Income from personal service contracts.....				
Nonpersonal holding company income (total).....	144,624	50.4		
Gains from sale of other capital assets.....				
Rents, 50 percent or more of gross income.....	144,624	50.4		
Other.....				
Taxable income <sup>2</sup> .....	189,525		189,525	
Corporate income tax.....	32,786		32,786	
Dividends.....	12,600		12,600	
Undistributed personal holding company income.....	0		144,139	
Individual taxpayer, 50 percent owner of corporation:				
Taxable income.....	68,549		140,618	
Individual income tax.....	27,493		75,585	
Increase in individual income tax.....			48,092	175.0

<sup>1</sup> For the "Proposal" column, the figure is "adjusted ordinary gross income."

<sup>2</sup> Before dividend received deduction.

*Case VI: Years 1958, 1959, 1960*

Corporation T is entirely owned by one person who is an entertainer. The corporation paid no dividends in the years in question. The corporation's major source of income is payments for the personal service of its sole stockholder. This stockholder serves as president of the corporation and receives as a salary 30 percent or less of the amount the corporation receives for his services as an entertainer. Although the present law classifies as personal holding company income amounts received by a corporation under a contract to furnish personal services if some person other than the corporation has the right to designate the person who is to perform the services, corporation T was not classified as a personal holding company because nonpersonal holding company income was between 25 and 30 percent of gross income. Practically all of the nonpersonal holding company income was made up of the gross receipts from business operations not falling within the personal service contract category. In 1 year, for instance, part of the nonpersonal holding company income was derived from the ownership of a bowling alley.

Corporation T would have been classified as a personal holding company in 1958-60 under the proposed revision of the law because over 60 percent of its adjusted ordinary gross income was from the type of personal service contract falling within the concept of personal holding company income. The reconstructed undistributed personal holding company income would have been about \$73,500 for 1958, \$86,000 for 1959, and for 1960, \$107,000. The addition of these amounts as dividends to the reported income of the sole stockholder would have increased his personal income tax in 1958 from nearly \$22,000 to \$70,500, from \$24,500 to \$81,500 in 1959, and from \$29,000 to \$101,500 in 1960.

## Case VI

	Present law, 1952 <sup>2</sup>		Present law, 1959		Present law, 1960		Proposal, 1958		Proposal, 1959		Proposal, 1960	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Corporation T:												
Gross income (total) <sup>1</sup> .....	\$333,433	100.0	\$390,593	100.0	\$477,039	100.0	\$332,683	100.0	\$384,950	100.0	\$476,638	100.0
Personal holding company income (total)....	241,000	72.3	293,000	75.0	343,000	71.9	241,000	72.4	293,000	76.1	343,000	72.0
Dividends.....												
Interest.....												
Gains from securities and commodity futures.....												
Rents, under 50 percent of gross income.....												
Income from personal service contracts <sup>3</sup> .....	241,000	72.3	293,000	75.0	343,000	71.9	241,000	72.4	293,000	76.1	343,000	72.0
Nonpersonal holding company income (total).....	92,433	27.7	97,593	25.0	134,039	28.1	91,683	27.6	91,950	23.9	133,638	28.0
Gains from sale of other capital assets.....	750	.2	5,643	1.5	401	.1						
Rents, 50 percent or more of gross income.....												
Other <sup>4</sup> .....	91,683	27.5	91,950	23.5	133,638	28.0	91,683	27.6	91,950	23.9	133,638	28.0
Taxable income <sup>4</sup> .....	142,880		172,949		211,944		142,880		172,949		211,944	
Corporate income tax.....	68,595		82,910		104,603		68,595		82,910		104,603	
Dividends.....	0		0		0		0		0		0	
Undistributed personal holding company income.....	0		0		0		73,722		85,807		107,040	
Individual taxpayer, 100 percent owner of corporation:												
Taxable income.....	52,873		58,853		68,080		126,595		144,660		175,120	
Individual income tax.....	21,781		24,387		28,915		70,500		81,287		101,665	
Increase in individual income tax.....							48,719	224.0	56,900	233.0	72,750	252.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."<sup>2</sup> Approximate.<sup>3</sup> Residual figure used in order to make items add to total.<sup>4</sup> Before dividend received deduction.

*Case VII: Years 1960 and 1961*

Corporation S is entirely owned by one individual and was a manufacturing corporation until 1954. At that time the operating equipment was sold, and the land and building previously used by the corporation, but rented by it from the sole owner, were transferred to the corporation. Since that time, the corporation's income has been from dividends, interest, capital gains, and rents. It has never paid any dividends. Corporation S was not classified as a personal holding company in 1960 and 1961 because rents were between 50 and 60 percent of gross income. Under the proposal, it would have been classified as a personal holding company. Rents, after deduction of interest, real estate taxes, and depreciation, would have been about 36 percent of adjusted ordinary gross income. Interest and dividends would have accounted for the rest of such income.

The owner of the corporation paid personal income tax of slightly over \$6,000 in 1960. The addition of the recomputed undistributed personal holding company income of \$16,500 to the stockholder's dividend income would have increased his income tax to \$13,500. In 1961 the stockholder's income tax would have been raised from about \$6,500 to nearly \$15,000 by the addition to his income as a dividend of the \$18,000 of undistributed personal holding company income of corporation S.

## Case VII

	Present law, 1960		Present law, 1961		Proposal, 1960		Proposal, 1961	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Corporation S:								
Gross income (total) <sup>1</sup> .....	\$48,755	100.0	\$57,521	100.0	\$30,985	100.0	\$33,105	100.0
Personal holding company income (total).....	19,200	39.4	27,478	47.8	30,375	98.0	33,105	100.0
Dividends.....	14,352	30.7	15,690	27.3	14,952	48.2	15,690	47.4
Interest.....	4,248	8.7	5,471	9.5	4,248	13.7	5,471	16.5
Gains from securities and commodity futures.....			6,317	11.0				
Rents—under 50 percent of gross income.....					11,175	36.1	11,944	36.1
Income from personal service contracts.....								
Nonpersonal holding company income (total).....	29,555	60.6	30,044	52.2	610	2.0		
Gains from sale of other capital assets.....								
Rents, 50 percent or more of gross income.....	28,945	59.4	30,044	52.2				
Other.....	610	1.2			610	2.0		
Taxable income <sup>2</sup> .....	18,714		26,710		18,714		26,710	
Corporate income tax.....	1,998		3,885		1,998		3,885	
Dividends.....								
Undistributed personal holding company income.....	0		0		16,716		18,087	
Individual taxpayer, 100 percent owner of corporation:								
Taxable income.....	23,695		24,842		40,411		42,929	
Individual income tax.....	6,127		6,643		13,524		14,918	
Increase in individual income tax.....					7,397	121.0	8,275	125.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."<sup>2</sup> Before dividend received deduction.



*Case VIII: Years 1958, 1959, and 1960*

Corporation R was originally owned by only one individual. Over the years he has given away 80 percent of his stock to his children. Most of the corporation's income is derived from interest, dividends, rents, and capital gains. Substantial dividends are paid each year, but the corporation always retained over 25 percent of its income in the years in question. It has not been classified as a personal holding company because 70 to 75 percent of gross income was derived from rents. Even under the proposed change in the method of computing rental income and gross income, the corporation would not have been considered a personal holding company because, in all years, rents still would have been over 50 percent of the revised measure of gross income (i.e., adjusted ordinary gross income). However, since other personal holding company income was over 10 percent of ordinary gross income, the rental income would have been classified as personal holding company income under the proposed revision.

If corporation R had been classified as a personal holding company, its undistributed personal holding company income would have been \$66,000 in 1958, \$88,000 in 1959, and \$60,000 in 1960. The addition of 20 percent of these sums to the income of the major (and original) stockholder's income as a dividend would have increased his personal income tax from \$29,500 to \$38,000 in 1958, from \$51,500 to \$60,500 in 1959, and from \$40,000 to \$48,500 in 1960.

## Case VIII

	Present law, 1958		Present law, 1959		Present law, 1960		Proposal, 1958		Proposal, 1959		Proposal, 1960	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
<b>Corporation E:</b>												
Gross income (total) <sup>1</sup> .....	\$951,967	100.0	\$998,238	100.0	\$1,028,699	100.0	\$681,344	100.0	\$719,541	100.0	\$718,550	100.0
Personal holding company income (total).....	282,681	29.7	300,096	30.1	262,372	25.5	678,208	99.5	702,370	97.6	679,148	94.5
Dividends.....	256,842	27.0	266,329	26.7	245,890	23.9	256,842	37.7	266,329	37.0	245,890	34.2
Interest.....	8,827	.9	16,490	1.7	898	.1	8,827	1.3	16,490	2.3	898	.1
Gains from securities and commodity futures.....	17,012	1.8	17,277	1.7	15,584	1.5	---	---	---	---	---	---
Rents, under 50 percent of gross income <sup>2</sup> .....	---	---	---	---	---	---	412,539	60.5	419,551	58.3	432,360	60.2
Income from personal service contracts.....	---	---	---	---	---	---	---	---	---	---	---	---
Nonpersonal holding company income (total).....	669,286	70.3	698,140	69.9	766,327	74.5	3,136	.5	17,171	2.4	39,402	5.5
Gains from sale of other capital assets.....	(465)	---	---	---	---	---	---	---	---	---	---	---
Rents—50 percent or more of gross income.....	666,819	70.0	690,969	68.2	726,925	70.7	---	---	---	---	---	---
Other.....	3,136	.3	17,171	1.7	39,402	3.8	3,136	.5	17,171	2.4	39,402	5.5
Taxable income <sup>3</sup> .....	271,549	---	308,078	---	267,251	---	271,549	---	308,078	---	267,251	---
Corporate income tax.....	17,471	---	32,075	---	20,483	---	17,471	---	32,075	---	20,483	---
Dividends.....	175,000	---	175,000	---	175,000	---	175,000	---	175,000	---	175,000	---
Undistributed personal holding company income.....	0	---	0	---	0	---	66,203	---	87,802	---	59,984	---
Individual taxpayer, 20 percent owner of corporation:												
Taxable income.....	65,838	---	114,885	---	77,183	---	79,079	---	132,445	---	89,180	---
Individual income tax.....	29,544	---	51,680	---	39,977	---	38,051	---	63,821	---	48,502	---
Increase in individual income tax.....	---	---	---	---	---	---	8,507	29.0	8,841	17.0	8,525	21.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."

<sup>2</sup> Under the proposal, rents constituting any proportion of adjusted ordinary gross income would be treated as personal holding company income if personal holding com-

pany income (other than rental income) constitutes more than 10 percent of ordinary gross income.

<sup>3</sup> Before dividend received deduction.

*Case IX: Years 1958, 1959, and 1960*

Corporation Q is 100-percent owned by one person. In 1958 and 1960 the corporation was not considered a personal holding company because rents exceeded 50 percent of gross income. However, in 1959 corporation Q was classified as a personal holding company because an extremely large capital gain from securities constituted 68 percent of gross income. In order to avoid payment of personal holding company tax, the stockholder had the corporation pay him a large dividend. This dividend was so large that the corporation had a dividend-paid carryover. In spite of this carryover and the fact that some dividends also were paid in 1958 and 1960, the corporation would still have had net undistributed personal holding company income of \$34,000 for the 3 years if it had been classified as a personal holding company in all 3 years.

Corporation Q would have been classified as a personal holding company in 1958 under the changes proposed in the House bill because rents as recomputed would have been almost 49 percent of adjusted ordinary gross income, and dividends and interest over 47 percent. The proposed changes would not have affected the previous personal holding company status for 1959 as rents would have been 39 percent of adjusted ordinary gross income. In 1960, the corporation also would have been classified as a personal holding company, even though recomputed rents were 58 percent of adjusted ordinary gross income, because over 10 percent of ordinary gross income was from dividends.

If classified as a personal holding company, corporation Q would have had undistributed personal holding company income of \$50,000 in 1958 and \$17,500 in 1960. The 1960 figure is net after the dividend-paid carryover from 1959. The addition of these sums as dividends to the stockholder's personal income would have increased his 1958 personal income tax from \$115,500 to \$137,500. In 1960 the increase would have been from \$24,000 to \$33,000.

## Case IX

	Present law, 1958		Present law, 1959		Present law, 1960		Proposal, 1958		Proposal, 1959		Proposal, 1960	
	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution	Amount	Percent distribution
Corporation Q:												
Gross income (total) <sup>1</sup> .....	\$399,733	100.0	\$1,051,536	100.0	\$288,979	100.0	\$234,774	100.0	\$209,063	100.0	\$184,852	100.0
Personal holding company income (total).....	176,692	44.2	1,042,147	99.1	69,622	24.1	226,101	96.3	199,674	95.5	177,355	96.0
Dividends.....	109,814	27.5	117,637	11.2	69,608	24.1	109,814	46.8	117,637	56.3	69,608	37.7
Interest.....	2,197	.5	2	( <sup>2</sup> )	14	( <sup>2</sup> )	2,197	.9	2	( <sup>2</sup> )	14	( <sup>2</sup> )
Gains from securities and commodity futures.....	64,681	16.2	716,013	68.1								
Rents, under 50 percent of gross income <sup>3</sup> .....			208,495	19.8			114,000	48.6	82,035	39.2	107,733	58.3
Income from personal service contracts.....												
Nonpersonal holding company income (total).....	223,041	55.8	9,389	.9	219,357	75.9	8,673	3.7	9,389	4.5	7,497	4.0
Gains from sale of other capital assets.....												
Rents, 50 percent or more of gross income.....	214,368	53.6			211,860	73.3						
Other.....	8,673	2.2	9,389	.9	7,497	2.6	8,673	3.7	9,389	4.5	7,497	4.0
Taxable income <sup>4</sup> .....	187,368		796,119		45,121		187,368		796,119		45,121	
Corporate income tax.....	28,322		176,848		1,431		28,322		176,848		1,431	
Dividends.....	60,000		100,000		12,500		60,000		100,000		12,500	
Undistributed personal holding company income.....	0		(13,272)		0		30,245		(13,272)		17,319	
Individual taxpayer, 100-percent owner of corporation:												
Taxable income.....	232,411		160,751		66,299		262,656		160,751		83,618	
Individual income tax.....	115,629		86,333		23,948		137,286		86,333		32,906	
Increase in individual income tax.....							21,657	19.0	0	0	8,958	37.0

<sup>1</sup> For the "Proposal" columns, the figure is "adjusted ordinary gross income."

<sup>2</sup> Negligible.

<sup>3</sup> Under the proposal, rents constituting any proportion of adjusted ordinary gross income would be treated as personal holding company income if personal holding com-

pany income (other than rental income) constitutes more than 10 percent of the ordinary gross income.

<sup>4</sup> Before dividend received deduction.

Senator DOUGLAS. \$900,000?

Secretary DILLON. \$900,000.

We would call that jumbo.

Senator DOUGLAS. Let's see now. This was a \$900,000 life insurance policy?

Secretary DILLON. Group.

Senator DOUGLAS. Tax free?

Secretary DILLON. That is right.

Senator DOUGLAS. I would say that was jumbo.

Now you exempt retired employees from the \$30,000 group term insurance limit, do you not?

Secretary DILLON. That was not our recommendation. The House did that.

Senator DOUGLAS. The House did it, but you do not protest it?

Secretary DILLON. We are not asking for changes for the reasons which I think I explained before. But we did not see any particular logic in exempting employees when they retired.

Senator DOUGLAS. May I ask, do you think that is a good thing to exempt retired employees from the \$30,000?

Secretary DILLON. We do not see any particular—

Senator DOUGLAS. If this were changed, it would have your platonic blessing even though not your active support?

Secretary DILLON. That is right.

Senator DOUGLAS. On this point you are neutral?

Now one of the ways in which taxes are avoided is, of course, through the corporate shield. One sets up a shield. A corporation will receive dividends.

Let me put it this way: You set up corporation B which receives dividends from X, Y, and Z, and then the corporation pays only 52 percent upon 15 percent of the dividends which it receives from the corporation, or 7.8 percent. Is this not a favorite device to avoid the payment of personal income taxes?

Secretary DILLON. Where this is a device is in the area of personal holding companies that the Congress legislated against some years ago, and we have recognized that over the years able and intelligent tax lawyers have found ways to move around those rules, so that we did propose a considerable tightening up in that area, and I am glad to say that that was generally approved by the House.

Senator DOUGLAS. Are you satisfied with the provisions on personal holding companies?

Secretary DILLON. The provisions on personal holding companies were as recommended by the administration with the exception that the House added to them certain transitional devices which would allow or facilitate someone who was caught—someone who had not been a personal holding company but under the strict interpretation became one, to liquidate his operation. That was something that they put in not at our recommendation. It is highly technical what they did there, but it was worked on by my staff at some length and when they got through they thought it was a reasonable transitional privilege which would probably encourage liquidation and thereby get us some revenue which we might not get otherwise. And so we accepted it, and it is acceptable to us.

But the tightening up provisions were almost identical with those which we suggested.

Senator DOUGLAS. I would like to read this question very slowly and very carefully so you may make a considered reply. It deals with personal holding companies.

Are there provisions in the personal holding company selections of the House bill that either arise from or are specifically designed to accommodate the case of one or a few specific taxpayers?

If so, would you for the record identify the provisions and the case that gives rise to it, though not, of course, the name of the person?

If not, would you so state for the record?

Secretary DILLON. I think that there was a very large business enterprise that would have been caught and is caught, will be caught, under these provisions as enacted.

Senator DOUGLAS. Would you give a rough outline of that?

Secretary DILLON. What?

Senator DOUGLAS. Would you give a rough outline about that enterprise?

Secretary DILLON. It is a very large enterprise.

Senator DOUGLAS. How large?

Secretary DILLON. I think it is many millions of dollars, \$50 million or more. It is a very big enterprise.

Senator DOUGLAS. And the stock in that corporation was held by how many people?

Secretary DILLON. I am not familiar with it, but it was one family.

Senator DOUGLAS. One family?

Secretary DILLON. One family, and they recognized the reasonableness of the provisions which we wanted to put in, and the Ways and Means Committee did too, and they were primarily interested in these transitional arrangements, so that they could rearrange their corporate setup and liquidate from a personal holding company position.

There also was one other I am told about which had to do with a provision which was inserted in the bill dealing with liquidation of foreign personal holding companies, which also arose out of the problem of a particular case.

Senator DOUGLAS. Would you furnish, if it is not inconsistent with anonymity, the number of the instances where the corporate shield has been used obviously to avoid taxation, or to reduce taxation?

Secretary DILLON. If we have specific instances, we will be glad to.

Certainly we have examples of how it has been used, and we could do that.

If we have specific instances we would be glad to furnish them, without giving the names.

(The following material was supplied for the record:)

#### GROUP-TERM LIFE INSURANCE—EXAMPLES OF "JUMBO" POLICIES

At present, there are about 200,000 employees receiving group-term life insurance coverage in excess of \$30,000 under plans established by their employers. While this is only a small percentage (about one-half of 1 percent) of the total number of employees covered under employer group-term life insurance plans, it does represent a sizable number of employees who are receiving a valuable economic benefit from their employers completely free of tax. These figures are substantially the same as those arrived at by the life insurance industry itself.

A number of specific instances of very large amounts of group-term life insurance coverage have come to the attention of the Treasury Department. As an

Illustration of the extent of "Jumbo" coverage, there should be cited the effects of typical company plans. Under the group-term life insurance plan of one large corporation, employees may receive insurance up to three times annual salary. In this particular case, one executive is covered for \$100,000. Moreover, there are about 4,000 other employees in the company with insurance in excess of \$30,000 with the amount of insurance ranging all the way up the scale to \$100,000.

Many large corporations have group-term life insurance plans under which employees receive protection equal to twice their salaries. At least four employees in one company called to our attention receive insurance coverage of between \$300,000 and \$400,000. Since a great number of group-term life insurance plans provide coverage for the corporation executives equal to at least twice salary, it would seem apparent that there are many corporate executives presently receiving large amounts of tax-free insurance coverage.

Senator DOUGLAS. When we were fighting the 1950 tax bill, the Treasury submitted for the record figures on 10 individual oil operators, showing their net income exclusive of oil, their percentage depletion deductions, their intangible drilling expenses and the amount of taxes they paid in the period of 1943-47.

I remember one instance of a man who over a period of 5 years had a total net income of more than \$14 million and he paid during that period a tax of \$80,000, or two-thirds of 1 percent.

Could you furnish for the record of these hearings comparable data for more recent years?

Secretary DILLON. I will see what can be done. I was not aware of that particular data, and I don't know whether our staff has that data up to date or can get it in time.

But I will certainly see what can be done, Senator. (The Treasury Department reported that the data requested was not available at this time.)

Senator DOUGLAS. At the press conference which was held on the President's message, tax message, in January, Mr. Harvey Brazor who was former head of the Office of Tax Analysis, stated that between \$12 and \$13 billion annually escaped taxation because no capital gains taxes were levied at death.

Do you think that is approximately correct?

Secretary DILLON. I would think that is probably a fair estimate.

As I understand it, there are about \$150 billion worth of unrealized appreciation now on securities and there probably is much more on real estate, and I think figuring out the average number of people-----

Senator DOUGLAS. \$12 to \$13 billion of capital gains now escapes taxation completely because it is transferred from one generation to another.

Secretary DILLON. I would say something of that nature. It may develop to be larger as time goes on because, of course, what we have witnessed is a period during which prices rose rather rapidly from 1946-47 to 1955-57, and as that property begins to pass into estates, this figure you mentioned may go up, because our actual estate tax or receipts are now going up very rapidly.

Senator DOUGLAS. Mr. Secretary, how can Members of the Congress face the taxpayers, how can they face the workman or small farmer who pays on an income of \$5,200, pays \$456 in taxes, how can we face them when these tremendous holes exist in the tax structure; people with incomes of over \$5 million paying no taxes whatsoever; with \$12 to \$13 billion of capital gains completely evading taxation through transfer at death; with \$3 billion of depletion allowances completely

free from taxation; with \$2 billion of intangible drilling and developmental costs written off virtually in the first year; with stock options; personal holding companies, and the whole range and gamut of special privilege?

How can we say it is too complicated to try to remedy these things?

I happen to be one who agrees with your idea of stimulating the economy through a tax reduction, but it seems to me that the administration is always taking a position that tax revision is important but when you throw reforms overboard to speed tax reduction it is permitting the pirates to take over the ship.

Secretary DILLON. We haven't felt we have thrown it overboard actually because I think we have made some advances here, no where near as much as we would like.

I think if we had had that capital gains tax at death or carryover basis it would have been one of the great advances that has been made. We were very sorry when that didn't carry.

Senator DOUGLAS. You recommended and the House passed the elimination of the 4-percent dividend credit.

This, as I understand it, will increase governmental revenues by about \$300 million a year together with the double exclusion.

Secretary DILLON. Together with the doubled dividend exclusion.

Senator DOUGLAS. The total effect would be that we would increase revenues by about \$300 million a year.

Secretary DILLON. That is right.

Senator DOUGLAS. Suppose the Senate eliminates that provision and retains the 4-percent dividend credit.

Would you recommend a veto under those conditions?

Secretary DILLON. Our position on that has been clear from the start. If that particular provision were eliminated, the Congress should readjust the rate scale according to the flow of benefits. In other words, the rate scale should be readjusted at the higher levels and not at the lower levels.

Senator DOUGLAS. Suppose that were not done. Suppose that all that happens—as you say, it is easy to put in a motion to strike and I think you are correct in that. That is a very witty and a very true remark. It is easy to eliminate provisions but hard to substitute provisions.

Suppose that all that is done is the retention of the 4-percent dividend credit and the elimination of its elimination. What would you recommend?

Secretary DILLON. We would run into a very difficult situation there, Senator, which I would not be prepared to answer right now, because we took the position, and we have maintained it, that proper fiscal responsibility meant that net loss of revenue out of this bill should not be more than somewhere in the general neighborhood of \$10 billion. We recommended something over \$10 billion originally.

Now largely because of the change in the capital gains rate where we were getting extra revenue from increased activity, the total has gone up to \$11 billion.

The President made it clear, and I think we did, that if that increased beyond that, we would not find this fiscally responsible and we would be faced with a very difficult decision.



It they accept this bill without making changes in the rate schedule, while striking this revenue raising measure, we would have not only the problem of inequity involved, but also we would have a very difficult fiscal and revenue situation. I don't know what the answer would be.

If it went substantially above \$11 billion—I don't think the President could accept it.

Senator DOUGLAS. Mr. Chairman, if I may take a minute to make a statement that perhaps would be more appropriate on the floor. But I think we should remember that the enactment of the 7-percent investment credit last year is going to cost \$1,200 million a year, the more liberal depreciation rate \$1,300 million, or a total of \$2½ billion given primarily to corporations, and they are primarily owned by those with incomes over \$10,000 or \$20,000 a year.

We should remember that in 1954 the 4-percent dividend credit was granted, which now costs \$460 million a year, and accelerated depreciation was put into effect in 1954, with a loss of several billions a year.

My estimates are that the tax burden of corporations since 1954 are being diminished at a rate of not far from \$5 billion a year, and all these truck holes remain in the tax system, and they are only very slightly reduced.

We should remember that while the individual income tax is progressive, and while the corporate tax has a progressive element, we should remember that there is still \$10½ billion of excise taxes which the Federal Government collects, the burden of which primarily falls upon the lower income group.

And that in the field of State and local taxation that total receipts last year were approximately \$54 billion, with the property tax yielding about \$18 billion, State sales taxes \$12½ billion, and that these are primarily regressive in nature.

It seems to me that the case of tax reform is very strong. Very frankly if this bill get any worse, it is going to be very difficult for some of us to vote for it. It is going to be very difficult for some of us to vote for it as it is. I would hate to see the reform provisions fade into the background.

The President said in 1961 there was going to be a thoroughgoing program in 1962; 1962 came along and the delay—it was not your fault, I agree, it was the fault of the House.

There was some reform in 1962, but there was going to be a thoroughgoing bill in 1963. Now 1963 comes in and very frankly there isn't much reform. Mr. Williams asked you about 1964. You replied that is an election year. Then 1965. How long, oh Lord, how long?

That is all, Mr. Chairman.

The CHAIRMAN. The Chair, if the committee desires, will ask the Senate to permit us to sit this afternoon to expedite these hearings. I would like some expression from the committee as to whether that is advisable. I think we will have to have Mr. Dillon back tomorrow because there are certain Senators who can't be here today, who desire to ask questions. We may be able to finish tomorrow.

Is there a judgment of the committee to sit this afternoon?

Senator RUBINOFF. Mr. Chairman, I have about three questions. I am supposed to preside at 2, and I don't know if they can get a sub-

stitute. I will take about 3 or 4 minutes. I don't know if Senator McCarthy has any questions.

The CHAIRMAN. I think there will be ample time tomorrow because the Secretary will be the only witness tomorrow except the Secretary of Commerce who has a short statement.

Senator SMATHERS. I think it would be a splendid idea if we could meet this afternoon, Mr. Chairman, and go forward. I know the Secretary has other things to do.

The CHAIRMAN. It is necessary for the Secretary to come tomorrow because there are certain Senators who are absent.

Secretary DILLON. I will be glad to be here this afternoon and tomorrow both. That is fine.

Senator SMATHERS. Will we have Senators here this afternoon I presume to question him?

Senator LONG. Couldn't we accommodate the Senator from Connecticut?

Senator RIBICOFF. I don't think I will take 5 minutes.

The CHAIRMAN. The Chair recognizes the Senator from Connecticut.

Senator RIBICOFF. Mr. Secretary, it is my intention to try to have added to this bill a provision allowing deduction for college expenses. I happen to believe that parents who are trying to send their children to college should be given every possible assistance to do so.

I know that the Treasury and probably you are opposed to this, and I would like to ask a few questions for the purpose of the record at this time before I go forward, which I intend to do. Would you please state for the record your objections to granting deductions to parents for the cost of college education?

Secretary DILLON. Our real objection to that, Senator, is that we felt that it is an inefficient and not particularly equitable way to handle the problem which we recognize. The basic problem is to enable people who have difficulty in affording an education to go to college. A tax deduction or a tax credit, of course, will not help those people. It will only help those who have enough income so that they can afford this. I would say that is the basic reason for which we have felt that this is unfortunate.

Now I think this has been recognized by many, because the primary job at the moment is buildings. We can't accommodate more students at college without adequate buildings. I think that bill is being considered right now, and I would hope very much it would pass.

I would just like to point out as you undoubtedly know, that the American Council on Education, which is the senior body in this field, which used to sponsor a tax credit for tuition no longer includes such a proposal. I think for the same reason.

Senator RIBICOFF. Frankly, I am unimpressed with what professional organizations on education think about this.

Secretary DILLON. You have a great deal of experience.

Senator RIBICOFF. We should give assistance to colleges, and I am for that, and I believe the Senate will adopt this kind of a bill on Monday, but what has this got to do with the other provision to do something for the parents of children?

Secretary DILLON. We feel that it is a highly costly procedure in that many people who would get such a credit would send their children to college anyway, and are doing it and don't really need it. It might as a deduction pay 10, 15, or 20 percent of the tuition cost of the student, which would not be a decisive element as to whether that student could go to college or not go to college.

And so we have favored instead to achieve the same objective and we are in entire agreement on the objective, either a combination of an increase in funds available under the National Defense Education Act for scholarships, direct scholarships, or a guarantee program whereby the Government would guarantee loans that banks might make to students that would be repayable at low interest over 10, 12, 15 years after they graduate.

Senator RUBINOFF. With a guaranteed loan, what would you do for the women who want an education and then don't have an earning capacity when they get married. Is a husband to take the wife who is a college graduate with a mortgage on her?

Secretary DILLON. That would be a little difficult.

Now another problem which this raises which I am sure you are aware of is that if there is such an exemption for tuition, many colleges have made no secret of the fact that what they will do is simply increase—use this as a reason to increase—their tuition so as to get the benefit themselves, rather than have the benefit go to the student.

To that extent it might make it harder for many low income students to actually get their education than it would be otherwise.

Senator RUBINOFF. The colleges don't need any reason like that to raise their tuition.

As I read the papers and follow the history of increases in tuition rates, tuitions are being raised every year without this provision.

Secretary DILLON. That is right. They would just be raised faster with it.

Senator RUBINOFF. Coming back to scholarship aid, scholarships are usually given to the boys and girls of families in the lowest income groups where the taxes paid by the parents are the smallest amount. These are the students who are eligible for and receive scholarships.

What I am concerned about are the parents earning \$8,000 or \$10,000 a year, because at that level of income they often cannot get a scholarship, and yet there is a serious difficulty faced by these parents in sending their youngsters to college.

Now this is where the great burden falls.

What are we going to do to encourage these people to send their youngsters to college?

Secretary DILLON. That is where we have our proposal for a loan program. When I say our proposal I mean the administration proposal; it isn't just the Treasury, it is the Department of the Treasury and the administration proposal to have a broad guarantee program of loans that could be repayable on easy terms.

Now certainly no program answers every possibility, but we recognize the problem lies where you say it lies, and we are trying to find

something that would meet it with the least cost to the Government and the most effectiveness to the student.

We think a substantial loan program of that nature would be better for a family with an \$8,000 income, that pays very little taxes anyway, and where the amount of credit they would get in their taxes would be very infinitesimal toward the cost of a college education.

Senator RIBICOFF. Last year you proposed a tax credit for business to encourage them to make capital investments.

This year you propose a deduction for all equipment devoted to research and development.

Now isn't the investment in the education of our children entitled to as much consideration and encouragement from the tax laws as investment in plant and equipment?

Secretary DILLON. Absolutely. It is just a question of how to do this most effectively.

Under this situation any bill that we have seen, and there have been a number of them, the bulk of the tax cost would go to families with incomes of over \$10,000, not to the \$8,000 to \$10,000 group that we are talking about.

Senator RIBICOFF. Isn't that the case, Mr. Secretary, with every deduction? Every deduction you have in the tax laws, the people with the higher income get the larger proportion of the savings from the deductions and this would apply here?

Secretary DILLON. Yes. I don't mean just that. Of course, that is true, but I mean the resulting revenue cost to the Government, the bulk of the amount that would be deducted would be in this higher bracket class, just because those are the people that can afford the rest of what it takes to send their children to college, whereas the ones between \$8,000 and \$10,000, this wouldn't make enough difference to get very many of them to go. It would certainly have some effect.

We just think it is a costly and inefficient means to achieve a very worthy end, and I just want to be very clear that there is no difference in the aim.

Senator RIBICOFF. But you don't have any better means. You don't have a more efficient means or a more effective means.

The President proposes giving credits and deductions for contributions to political campaigns.

Why isn't it just as important to give a deduction for a child's education?

Secretary DILLON. We feel that the loan program that we recommend—and I am no expert, I feel quite at a loss trying to answer questions to someone like yourself who knows so much more about this.

Senator RIBICOFF. You see here is why I am pressing this. I am very sincere about this and I am going to make a hard try to do this, because administration after administration has opposed it.

I am not saying this about your arguments, but the arguments have been specious that have come from administration after administration and Treasury official after Treasury official.

There are over 100 bills before the Congress of the United States trying to achieve and accomplish this. Yet the pattern of no action has been repeated over a period of years.

A tax bill comes into the House under a closed rule so no one has an opportunity to put this amendment on. But we do have a problem, and I think it is a problem that we should try to tackle. I would rather see a loss of revenue from this type of deduction and close up some of the loopholes such as related by the Senator from Illinois or the Senator from Delaware, and make that money available for parents for tax deductions.

So it isn't a question of revenue, it is a question of burden.

Now we provide for deductions for a family that has extraordinary costs because of sickness.

We provide deductions for people who have casualty losses.

Now a family raises children, and then comes a 4-year period which to them is an extraordinary period because they want to send their son or daughter to college, but they face a serious financial burden in doing this.

Now if part of our tax laws are to alleviate some of the burdens for the unusually heavy costs that some families have to meet, why shouldn't we face up to the fact that college expenses are an unusually heavy basic cost that we should try to alleviate through the tax laws?

Secretary DILLON. It is my understanding that the Department of Health, Education, and Welfare, that has responsibility in the executive branch for this, feels that the loan program we recommend would be more effective in answering the problem.

Senator RIBICOFF. You see this is the difference.

I am on this side of the table now instead of that side, and I am not bound any more as a U.S. Senator by what the Budget Bureau or the Secretary of the Treasury or the President of the United States may think.

So, therefore, as a Senator I do not have the same restrictions as to policy as I had as a member of the executive branch.

Now I can look at this realistically and try to accomplish things that I would like to have accomplished in the other position.

Senator DOUGLAS. I will say this is a typical illustration of how a man's character improves when he moves out of the executive branch into the legislative branch.

Senator RIBICOFF. I would agree without question.

Thank you very much.

Senator DOUGLAS. Mr. Chairman, I ask unanimous consent that a table which I have prepared which I believe to be accurate on the fate of the administration reform proposals in the House bill be printed at the conclusion of this morning's testimony, subject to correction by the staff of the Secretary.

(The table as revised by the Treasury Department follows:)

SUMMARY OF FATE OF ADMINISTRATION STRUCTURAL AND TAX "REFORM"  
PROPOSALS IN HOUSE BILL.

<i>Administration reform proposal</i>	<i>Included in House bill</i>
Minimum standard deduction.....	Yes.
Child-care revision.....	Yes, partially.
Revise tax treatment of the aged (\$300 flat credit).....	No.
Income averaging.....	Yes.
Employee moving expenses.....	Yes.
Broader group of charities eligible for 80 percent personal deduction.....	Yes.
Expensing of research and development expenses.....	No.
5 percent floor on itemized deductions.....	No; but some taxes eliminated as personal deduction.
Single "floor" for medical and drug deductions.....	No; but 1 percent drug floor waived for those over 65.
Disallowance of minor casualty-loss deductions.....	Yes.
Unlimited charitable deduction repeal.....	No.
Sick-pay repeal.....	Not repealed; but exclusion limited to those who are sick 30 days instead of 7.
Limit tax-free group-term insurance to \$5,000.....	Limited to \$30,000 instead.
Repeal \$50 dividend exclusion.....	Exclusion doubled to \$100.
Repeal 4 percent dividend credit.....	Yes.
<b>Oil proposals:</b>	
Disallow carryover of excess deductions.....	No.
Disallow "grouping" of properties.....	Yes.
"Recapture" capital gains on sale of oil.....	No.
Restrict foreign tax credits.....	No.
Personal holding companies.....	Yes.
<b>Capital gains:</b>	
Include only 30 percent of gains rather than 50 percent.....	40 percent inclusion after 2 years.
Tax unrealized gains at death.....	No.
Make holding period 1 year, instead of 6 months.....	No.
Indefinite carryover of capital losses.....	Yes.
Repeal capital gains for livestock.....	No; but ineligible for 40 percent inclusion.
Repeal capital gains for timber.....	No; but ineligible for 40 percent inclusion.
Repeal capital gains for lump-sum benefits.....	No; but ineligible for 40 percent inclusion.
Repeal capital gains for stock options.....	No; but some other restrictions contained in bill.
Repeal capital gains on coal royalties.....	No; but ineligible for 40 percent inclusion.
Repeal capital gains on patents for inventors.....	No; but ineligible for 40 percent inclusion.
<b>Real estate:</b>	
End "fast depreciation".....	No.
"Recapture" excess deductions.....	Limited provision enacted.
Travel expenses.....	No.
Borrowing to buy life insurance.....	Yes.
Reversal of corporate normal tax and surtax rates.....	Yes.
Repeal of consolidated returns penalty.....	Yes.
Limit on multiple surtax exemption.....	Limited provision enacted.
Limit capital gains on disposition of assets for deferred payments.....	Yes.
Limit capital gains on sale of life estates.....	No.

The CHAIRMAN. The committee has been given permission to sit by the Senate.

We will reconvene at 3 o'clock. I hope all Senators will be present. (Whereupon, at 12:35 p.m., the committee recessed to reconvene at 3 p.m. of the same day.)

## AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

The chairman recognizes Senator Anderson.

Senator ANDERSON. Mr. Secretary, you testified that except for capital gains nearly all of the provisions of this bill are acceptable to the Treasury Department. Does that mean that the Treasury Department does not want us to make efforts to repeal some portions which it thinks are bad?

Secretary DILLON. No. Our position is that we are not of ourselves urging any other changes. We naturally expect that, as a result of thorough consideration by this committee in the hearings and the witnesses that changes will be made to the bill, and improvements accomplished. We expect that, and we will be glad to cooperate in it. But we are not making suggestions of our own for other changes at this time.

Senator ANDERSON. I was certain that was your position, Mr. Secretary, but I wanted to get it for our record when we start to mark it up, if we start to make a change in a section, even though it was held sacred by the House, that does not mean that the administration is opposed to it?

Secretary DILLON. Oh, no.

Senator ANDERSON. If it follows a pattern which you follow, it is desirable.

Secretary DILLON. That is right.

Senator ANDERSON. Section 1 of the bill says:

It is the sense of Congress that the tax—

This is in your report—

It is the sense of the Congress that the tax reduction provided by this act through stimulation of the economy will after a brief transitional period raise rather than lower revenues and that such revenue increases should first be used to reduce the deficits in the budgets and then to reduce the public debt.

Do you see any point in having a thing of that nature in the bill?

Secretary DILLON. I think that the whole of section 1 is important. What I quoted there was merely introductory language, giving the philosophy of it.

But the second part of section 1 says that the Congress accepts the responsibility to work toward this end, and that the President do the same.

Senator ANDERSON. Of course if we are working toward the end of the reduction of the public debt, we might not be advocating the tax cut at this time.

Secretary DILLON. Their theory is—that is why this language was put in—that the tax cut over a period of a few years will actually wind up by producing larger revenues for the Treasury than if we continue with our present overly repressive tax system which has led to numer-

ous recessions and probably will again, with accompanying great reductions in revenues.

Senator ANDERSON. Do you believe that this sort of pious declaration that money is going to be used to reduce the public debt has any legal effect of any kind?

Secretary DILLON. No. I think there is no legal effect at all, but I do think if one reads the debate, as I did, carefully, in the House of Representatives, it was very clear that there was a strong moral commitment there, and many Members committed themselves to exercise extreme restraint on further appropriation bills if this bill should be enacted.

And certainly I think that the results we have seen this year in attitude of the Congress toward appropriations is in large part or in part a reflection of the fact that they recognize that there is a possibility that there will be substantial tax reduction and to prepare for that they are trying to hold down appropriations.

Senator ANDERSON. Mr. Secretary, I was in the administration when there were many cancellations after the last World War and the public debt was reduced down to about \$276 billion, as I remember it, from the authorized figure way above that, and a great many people pledged themselves to reduce the public debt. Only one man that I knew of in public life took a contrary view and that was Jesse Jones. He said that we cannot pay it off, we never will attempt to pay it off, we never can pay it off, but it can gradually be reduced by the shrinking value of the dollar, and a portion of the debt has been paid by that fashion but nothing else has ever been paid on it, has it?

Secretary DILLON. No, that is true.

I think to actually contemplate paying off the debt in any substantial quantity as compared to reducing it by relatively minor amounts is a very tall order. I think what they are really aiming at is a balance in our budget so it does not continue to increase as it has.

Senator ANDERSON. Personally, I do not worry about the size of the national debt any more. I have given that up. I would hate to see what might be regarded as a promise that the Congress is going to cut the national debt, because I do not think the Congress ever will.

Secretary DILLON. I do not think that most of the Members felt that this involved the ability to make much reduction in the debt. I think it was more aimed at achieving a balance rather than that.

Senator ANDERSON. It sounds nice though, does it not?

Secretary DILLON. I agree with that.

Senator ANDERSON. Now this matter of capital gains, does the Treasury prefer to leave the capital gains alone rather than accept what the House put in?

Secretary DILLON. Yes, we prefer that it be left alone as is, with one exception. One of the changes suggested by the House, which is a rather minor one, we think has equity behind it, and this was the one dealing with the carryover of net losses which is now limited to \$1,000 a year and 5 years. The House provision would make that indefinite. That largely helps smaller people who do not have gains to offset losses against and cannot offset a large one-time loss in 5 years. It gives them more time.



Senator ANDERSON. Is there not a theory in some of the countries that capital gains could be reduced to maybe 12½ percent of some figure of that nature rather than increased?

Secretary DILLON. I think that the New York Stock Exchange has the view that that should be done, and in a number of countries there is no taxation at all of capital gains, although I think we were about the first country, and maybe one of the only countries now, to tax capital gains. But we have done it for a long time, and I think that the tendency now is in the United Kingdom to begin to move in that same direction for the first time.

Senator ANDERSON. Yes, but this bill raises the capital gains levy.

Secretary DILLON. Oh, no.

Senator ANDERSON. Well, it will have that effect.

Secretary DILLON. How?

Senator ANDERSON. You wait 2 years on these things to handle them, and you will be taking short-term profits instead of waiting for a capital gains tax.

Secretary DILLON. Oh, no. I think there is a misunderstanding there. That is one of the reasons why we are not very happy with the bill, because in the reduction of capital gains tax they do it in a very complex way. They do not change the present short-term treatment, which is under 6 months. They do not change the treatment between 6 months and 2 years. That remains the same as it is now. So you have a 50-percent inclusion factor in the top rate of 25 percent just the way it is now. Then they add on a third way of treating capital gains after 2 years, which is a lower rate. Therefore, that greatly complicates the tax return and the whole business. We think it is this additional reduction after 2 years that is unnecessary and should be eliminated. In other words, it would leave the law as it is today.

Senator ANDERSON. Is the Treasury still of the opinion that the investment credit has had a stimulating effect upon business?

Secretary DILLON. Yes, and I think that we have certainly had a lot of unsolicited views from various business organizations saying that this has occurred. Obviously the most noteworthy one is in the railroad industry where they have had a tremendous increase in their purchases of equipment, which they attribute largely to the investment credit. But we have had a number of other industries that have written to us and said that while they had not realized how it would work before, they now feel that it is very helpful, and urge that we support this move that the Ways and Means Committee started to eliminate this reduction in basis which complicates their bookkeeping.

Senator ANDERSON. There has been some comment on the provision in this bill about authors, prizefighters, movie people, and so forth being given more favorable treatment on their contracts. Is there such a provision in the bill?

Secretary DILLON. There is a provision in this bill that I think most tax experts have for a long time felt was equitable and fair, and which would help—I do not know about movie people but which would help authors, it might help certain actors. It would also be of great help to certain farmers. This is an averaging provision whereby, if you have a very good year, you can average it in effect over a 5-year period.

This would certainly help an author who wrote a book and got all the income in 1 year, although now an author can still get around the present situation by arranging to receive payment in installments over a period of years, and then he is only charged as those installments come in on his tax.

But one place where this would be very effective is in the agricultural area and the truck gardening area where crops, particularly in the South, a place like Florida, where they have many failures and then they have a success which they make a great deal of money out of. This will allow them to spread that over the 5-year period.

Senator ANDERSON. In that spread-out provision there was a lawsuit brought by a football coach against the Saturday Evening Post in which he got a judgment for \$3,060,000. Would this bill save him \$750,000 roughly?

Secretary DILLON. That certainly would be taxable if he ever collects the judgment, and I would have to check with my specialists here whether that type of income would be in. I think it would.

Senator ANDERSON. I think he would save \$750,000 under this bill if he got it.

Secretary DILLON. I think he probably would.

Senator ANDERSON. Would he need that much?

Secretary DILLON. There was a provision put in the House so that this does not apply to profits that may accrue from wagers, so that is eliminated.

Senator ANDERSON. The jury found he had not been wagering, I think.

Secretary DILLON. That is right.

Senator ANDERSON. I just wonder how many such provisions there were. If he collects this in damages it is all immediately taxable. His tax would be very substantial. But if the provisions of this law are effective, he saves \$753,000 more than he would under the present law.

Secretary DILLON. That sounds like a lot but it may be correct. I would be glad to try and have our people check the figure on that.

(The following material was submitted for the record:)

#### AVERAGING PROVISION—EFFECT ON JUDGMENT OF \$3 MILLION

The following is in response to an inquiry as to potential effect of the averaging provision in H.R. 8363 on a judgment of \$3 million taxable to the recipient thereof as ordinary income in the year of receipt. The exact tax savings under the House bill will depend on whether the income is received in 1964 or in a subsequent year. In any event the tax reduction under the House bill will be due principally to the reduction in rates and not to the averaging provision. The taxes due under various assumptions are listed below:

Present rates.....	\$2, 670, 000
1964 rates:	
Without averaging.....	2, 335, 280
With averaging.....	2, 244, 215
1965 rates:	
Without averaging.....	2, 126, 980
With averaging.....	2, 059, 090

The taxes have been computed on joint return rates and assuming annual salary income of \$20,000 for all years. The above figures are only approximate since no account has been taken of deductions, exemptions, etc.

The tax reduction under the House bill if the judgment is collected in 1964 will be approximately \$435,000, of which \$91,000 is attributable to the averag-

ing provision. If the judgment is collected in 1965 or a subsequent year, the total tax reduction compared to present tax rates will be approximately \$620,000, of which \$68,000 is attributable to the averaging provision.

It should be noted that the averaging provision is of only limited benefit in this situation since, when the income greatly exceeds the highest rate bracket, spreading the income over several years results in only limited reductions in tax.

Secretary DILLON. Of course, this also does help lawyers who work for many years on a case and finally a case comes through and they get a fee for 4 or 5 years' work all at once. They can spread it back over the period of time they have earned it.

Senator ANDERSON. Can they not do that now?

Secretary DILLON. Only to a certain extent.

Senator ANDERSON. One lawyer did. One lawyer got a \$3 million fee.

Secretary DILLON. There are some special provisions in the law which allow averaging in special cases now and those are all abolished and this one simple provision put in instead of the special provisions which are now in the law.

Senator ANDERSON. Would you be disturbed if the committee tried to fix this so that there would not be this three-quarters of a million dollars windfall to one individual?

Secretary DILLON. No. If we can find any way—they did have this one change which was made by the House Ways and Means Committee which we would be glad to accept, which eliminates wagering, which we had not thought of. This probably does not come into it, but I have just been told by my experts that there is a special averaging provision in the law now which covers punitive damages when they are received as a result of violations of the antitrust law, and so there are a whole lot of special things like that.

Senator ANDERSON. There is some effort made to tie this into collusion if they did not get it under the antitrust law. I am talking about a specific case.

Secretary DILLON. If we think specific areas ought to be excluded, I think some language should be included to take care of that.

Senator ANDERSON. I am thinking of other situations where the astronauts are going to get their pay spread over a 10-year period though the performance will be in a short period. If that is true, why cannot everybody start figuring their pay over a long period of time.

Secretary DILLON. I think the astronauts, as you have pointed out, have already taken care of the situation by the nature of their contracts. They get paid over a period of years and they do not need this averaging provision.

Senator ANDERSON. They are very fortunate in that respect.

Now, Mr. Secretary, I do not intend to take further time questioning. In general I hope to see a tax bill passed as quickly as possible. I hope it will be passed before the first of the year. I fear it will not, but I hope it will. But I do believe that it is an obligation on our part to try to take out of this thing as many bad things as we can and try to put into it as many good things which were left out in the House and I am happy to have your commendation on that sort of an effort.

Secretary DILLON. Fine.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Secretary, the hearing today brought back memories of the 1954 Revenue Act. There are several members on both sides of the aisle who were present as we wrote the Revenue Act of 1954.

I could not help but think back on some of it as we were getting some statements this morning about trickle down, about deficits.

I have here the Internal Revenue Code of 1954 and the report of the Committee on Ways and Means, March 9, 1954. The situation at that time was reversed. The present majority party was the minority party. They wrote some minority views. It is found—

Senator ANDERSON. That is probably how they got to be the majority party.

Senator CARLSON. Anyway, there is one or two interesting sections in this in regard to the House bill which reported it. I do not find the page of it here, V-2 found in this Internal Revenue Code under 1954, under title "Reports."

One paragraph in this minority review reads this way:

The majority party repeatedly promised during the last campaign not only to reduce taxes, but also to balance the budget. In the face of a \$3 billion deficit in the current fiscal year, they have endorsed the reductions in this bill. The Republicans are in control of the administration and the Congress and it is their decision to engage in deficit financing.

Now in view of the fact that this bill we are considering now—I have here H.R. 8363—do you think that this bill with, what is it, a \$9 billion deficit, would be more acceptable, should be more acceptable?

Secretary DILLON. The deficit will be less. It is down to around \$9 billion now. But from what you have read, and if in the face of that the Republicans nevertheless put through that tax cut, I would hope and expect that I would have broad support from the Republican Party for this tax cut.

Senator CARLSON. We shall give some consideration to it, but I was interested in another paragraph in this—there were the words "trickle down," I thought we had forgotten that but it came up this morning.

In this minority view, in order to make it a little historical here:

Tax reductions indulged in by the majority in this bill show a singular purpose to benefit a small minority of taxpayers at the expense of a substantial revenue loss to the almost complete exclusion of the average taxpayer. The bill exudes the trickle-down theory of the taxation of Alexander Hamilton and, more recently, Andrew Mellon. It was this theory which contributed greatly to the economic chaos in the 1930's.

Now I heard those words "trickle down" this morning, and it brought back some of those memories. I thought we ought to from a historical standpoint at least make it a matter of record.

Then I come to the reverse. In this year's bill, the majority party, which was the minority party in the 1954 act, of course, is now the minority party. They have a minority view also, and it is found in the report here, House Report 749, and I just want to read one paragraph to make it a matter of history:

In opposing the enactment of this bill, the undersigned Republican members of the committee do not abandon the longstanding Republican position that the excessive tax burden and steeply progressive tax rates should be reduced. It is our position that such reductions can be made with constructive results only when the overall fiscal policy of the Government will justify it.

In other words, tax reduction should be accompanied by a reduction, not an increase, in the level of Government expenditures. This was the Republican position in 1947, again in 1954, and it is our position today.

And on that I stand, Mr. Secretary. I wanted to make this a matter of record because I thought it was historical. That is the only reason I took the time.

Senator DOUGLAS. I thought you were going to say the first quotation you read was a criticism by the Republicans of the tax bill of this year.

The CHAIRMAN. There is a vote, final passage of the bill pending. We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 3:40 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, October 17, 1963.)



# REVENUE ACT OF 1963

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THURSDAY, OCTOBER 17, 1963

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

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

Present: Senators Byrd (chairman), Long of Louisiana, Anderson, Gore, Talmadge, Ribicoff, Williams, Dirksen, and Carlson.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Secretary of Commerce is unable to be here this morning, so he has filed a statement. But he will be glad to come back to be interrogated by the committee at any time. I ask that the statement be put in the record.

(The statement referred to follows:)

## STATEMENT OF HON. LUTHER H. HODGES, SECRETARY OF COMMERCE

Mr. Chairman, I greatly appreciate your invitation to testify on the President's tax reduction program. I support this legislation: We need this tax cut. We need it to quicken the pace of economic growth, to reduce the backlog of unemployment and to increase the use of our industrial plants and other resources of the country. We need this tax cut to help us reduce our balance-of-payments deficit and keep our dollar strong in international financial markets. Finally, we need this tax cut to liberate our private enterprise economy from the lingering burden of a wartime tax system.

I could talk with this committee at great length about a number of issues in this tax bill which are of vital concern to all of our citizens. However, because I know you are anxious to move ahead as rapidly as possible in the consideration of this measure—and because you will hear from experts on many of these issues—I will restrict myself to some of the ways in which a lessening of our heavy tax burden will stimulate the business sector of our economy. This tax reduction will greatly quicken the overall rate of growth of the economy, a rate which has been far from satisfactory. Greater vigor in economic and business activity in turn will reduce the nagging and persistent high rate of unemployment. With rising business, consumer incomes will rise and their expenditures on goods and services will expand along with their take-home pay. With this tax cut our business profits will be increased, and businessmen will have a new incentive to modernize and expand their productive facilities. This further modernizing of our plants will mean increased efficiency at home and increased competitiveness of our products abroad. As you know, we are now engaged in a major effort to expand our exports, and exports will be greatly helped by lower cost of production in our domestic firms.

Before we look more closely at some of the ways the tax reduction will assist business, let me review briefly current business conditions. The economy is in an advanced phase of its fifth postwar upturn. Since the early part of 1961, production, employment, personal income, and corporate profits have climbed to record highs without pronounced price increases.

Gross national product in the second quarter of 1963—the latest quarter for which we have data—was running at a seasonally adjusted annual rate of \$580 billion. This was a \$27 billion increase, or 5 percent, over the second quarter of 1962. Since prices have risen  $1\frac{1}{2}$  percent over the past year, the bulk of the rise in current dollars represents an increase in physical volume terms. It appears that a further rise in GNP took place in the summer quarter.

This means that the current upturn has now passed its 10th quarter. Our previous expansion, 1958-60, lasted only 9 quarters, and the one before that, 1954-57, lasted 13 quarters. It seems clear that, in view of previous experience, we should be prepared at this time to strengthen our defenses against recession by expanding the demand for goods and services. This tax reduction will lend that kind of support.

When we examine personal income, it is quite evident that there has been a little slowing down in the pace of our advance this summer. During the spring, activity rose at a very rapid pace. From March to June, for example, total personal income increased from a seasonally adjusted annual rate of \$455 to \$463 billion, or by \$8 billion. From June to September, on the other hand, the advance was only \$3 to \$4 billion. Where payrolls were up by \$7 billion over the spring, their rise over the third quarter has been quite small.

Business expenditures for new plant and equipment have been moving up since the first part of this year. For the year as a whole, outlays are scheduled to total some \$39 billion, almost \$2 billion more than last year's \$37.3 billion. Fourth quarter plans reported by business in our last survey point to an expenditure of \$11 billion at a seasonally adjusted annual rate—8 percent above a year ago. Favorable earnings and earnings prospects, including the benefits of the 1962-enacted investment tax credit, and the increased cash flow made possible by last year's revision of depreciation regulations have been important factors in the investment factors in the investment advance.

Although investment is currently at a record rate, we have been somewhat disappointed in its performance over the past several years. It has not exhibited the buoyancy which was evident in the earlier postwar years. The persistence of excess capacity in a number of areas, despite the rise in output that has occurred has been the main influence dampening the investment rise.

Rising construction outlays have made an important contribution to increased economic activity this year. However, private residential construction outlays, after rising strongly through the spring, have leveled off in the last few months.

This proposed tax cut will help produce increases in employment and will substantially reduce our present high rate of unemployment. So far this year, unemployment has averaged 4.2 million, despite rising economic activity. In the first 9 months of this year, an average of 5.7 percent of the civilian labor force has been unemployed.

I might point out that while our unemployment has remained at a high and undesirable rate, employment has been increasing. In 1959, following the recession year of 1958, total civilian employment increased 1.6 million, from the 64 million employed in 1958; in 1960 the employment gain was 1.1 million. In 1962, employment rose by 1.2 million over the recession year 1961; and this year employment will average about three-fourths of a million above last year. Yet with these increases in employment, the unemployment problem is still severe. Since the recession low of 1958 we have been able just about to provide jobs for the additions to the labor force but have not been able to make any significant dent in the high unemployment rate. Why?



The cause of the high unemployment rate is the relative weakness in demand for goods and services by consumers and business. In the last 5 or 6 years, the rate of growth in purchasing power and production has not been sufficient to give us full employment. In the recession of 1953-54, real GNP was reduced by 3.7 percent from second quarter 1953 to the second quarter 1954. At the same time, unemployment increased by some 2 million, seasonally adjusted, or from a rate of 2.6 to 5.8 percent. As demands increased later in 1954 (in part due to the tax cuts enacted by the Congress that year) production advanced, and the unemployment rate was cut to a little more than 4 percent by mid-1955.

In the 1957-58 recession, GNP declined by 4.4 percent from the third quarter of 1957 to the first quarter of 1958; the unemployment rate rose from an average of 4.3 to 6.3 percent. With the increase in purchasing power, as 1958 progressed, the rate of unemployment declined. However, at no time since 1958 have purchasing power, demand, and production risen back to their long-term trend as projected from the period 1948-57. The average annual growth rate as measured by real GNP in this period was 3.8 percent; since 1957 the average annual increase has been about 3 percent. The fact is that before we reached full recovery and utilization of resources, we had another setback in the 1960-61 period.

What I am saying is that for 6 years our economy has experienced a slow rate of economic growth due to an inadequate expansion of income and production with the result that both human and physical resources have been underutilized. If our economy had continued to expand at a rate of 3½ percent per year, in terms of real GNP, since the low unemployment years of 1955-56, we would now be enjoying a production rate \$25 to \$30 billion above the current rate; we would have a much lower rate of unemployment and a greatly improved Government budget position. I believe a tax cut on personal and corporate incomes will go a long way in closing the gap between the potential production and employment, and our present levels.

The reduction in individual income taxes outlined in this measure will greatly stimulate consumer expenditures and business sales. If individual income taxes are reduced, people would spend the bulk of the increase in their take-home pay on purchases of goods and services. The general conformity of total consumer spending to personal income is shown in the accompanying chart 1 and table 1. Consumers have tended to spend a nearly constant proportion of their after-tax income since 1950. Since that year the ratio of consumer expenditures to the disposable personal income—total personal income less personal tax payments—has been confined within the range of 92 to 94 percent. This past experience suggests that if the Congress were to reduce personal tax rates, consumer spendable income would be expanded, and this would result in an expansion of consumer buying.

# PERSONAL INCOME AND CONSUMER SPENDING IN THE POSTWAR PERIOD

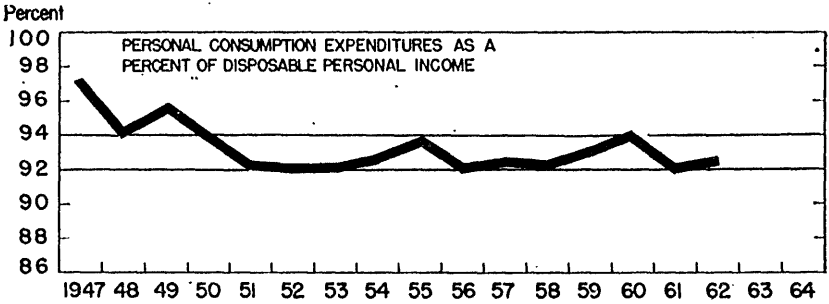
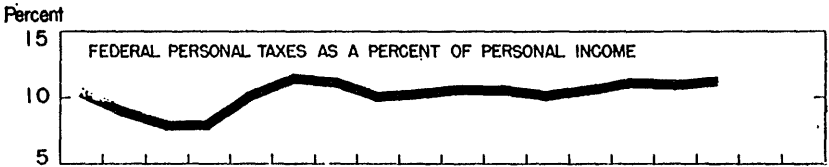
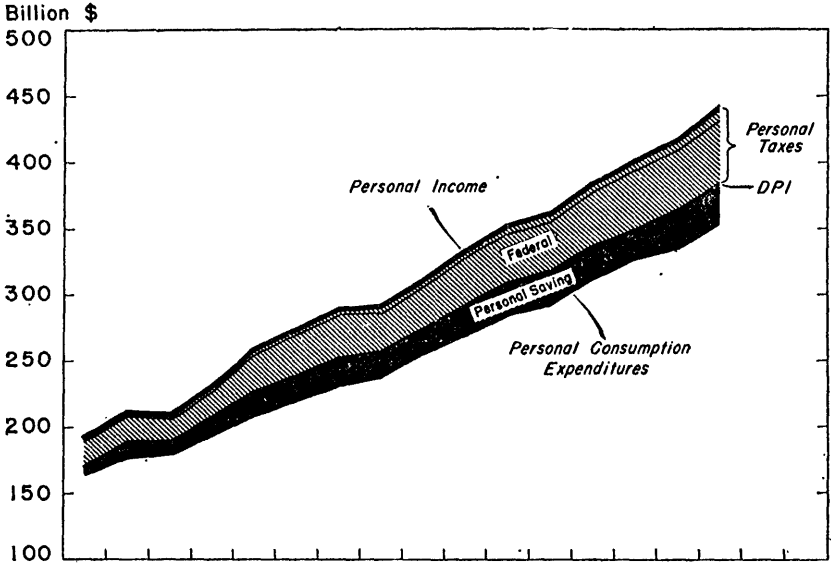


TABLE 1.—Personal income and consumer spending in the postwar period

	Personal income	Personal taxes		Disposable personal income	Personal saving	Personal consumption expenditures	Ratio of—	
		Total	Federal				Federal personal taxes to personal income	Personal consumption expenses to disposable personal income
1947.....	101.6	21.5	19.6	170.1	4.7	166.4	10.2	97.2
1948.....	210.4	21.1	19.0	189.3	11.0	178.3	9.0	94.2
1949.....	208.3	18.7	16.2	189.7	8.5	181.2	7.8	95.5
1950.....	228.5	20.8	18.2	207.7	12.6	195.0	8.0	93.9
1951.....	256.7	29.2	26.3	227.5	17.7	209.8	10.2	92.2
1952.....	273.1	34.4	31.2	239.7	18.9	219.8	11.4	92.1
1953.....	288.3	35.8	32.4	252.5	19.8	232.6	11.2	92.1
1954.....	289.8	32.9	29.2	256.9	18.9	238.0	10.1	92.6
1955.....	310.2	35.7	31.5	274.4	17.5	256.9	10.2	93.6
1956.....	332.9	40.0	35.2	292.9	23.0	269.9	10.6	92.1
1957.....	351.4	42.6	37.3	308.8	23.6	285.2	10.6	92.3
1958.....	360.3	42.3	36.6	317.9	24.7	293.2	10.2	92.2
1959.....	383.9	46.8	40.4	337.1	23.6	313.5	10.5	93.0
1960.....	401.3	51.4	44.0	349.9	21.7	328.2	11.0	93.8
1961.....	417.4	52.9	45.1	364.4	27.6	336.8	10.8	92.4
1962.....	442.1	57.7	49.0	384.4	20.1	355.4	11.1	92.4

Source: U.S. Department of Commerce, Office of Business Economics.

The tax reduction will greatly strengthen business investment incentives. For corporations, the tax cut would amount to \$2.2 billion. When this decrease is added to the investment credit and depreciation reforms provided last year (which together yielded almost \$2.3 billion), corporate tax liabilities will have decreased by \$4.5 billion. These benefits will raise the profitability of new corporate investment by almost 35 percent. In general, the higher the expected net return on capital, the greater is the willingness of business firms to take the risk associated with long-term capital accumulation. Moreover, the tax reduction will yield an additional volume of internal funds to help finance plant modernization and expansion of productive facilities.

I would like to stress the proposed clarification of the investment credit adopted in 1962. The new bill would repeal that section in the 1962 measure requiring a businessman to reduce the book value of his property for depreciation purposes by 7 percent to reflect the investment credit. Under the new section, a businessman can figure his depreciation of eligible property on the basis of a full dollar—rather than 93 cents—of investment value. This change will improve the effectiveness of the investment credit by raising the rate of profitability on newly acquired capital equipment. This expansion in investment will in turn improve the overall performance of the economy.

The strengthening of investment incentives is especially significant for small business. It is estimated that there are 4.5 million small businesses in the United States (representing 95 percent of all business firms). These small businesses do two-fifths of the total business volume and employ almost 30 million people. The tax burden of small firms, with taxable income of \$25,000 or less, will be cut by almost 27 percent. For these small businesses (which typically do not have ready and easy access to the capital markets), the availability of internal funds will be expanded. Thus, they too will be able to enlarge their activities. In addition, the more than 9 million small businesses organized as individual proprietorships will benefit from reductions in individual income tax rates.

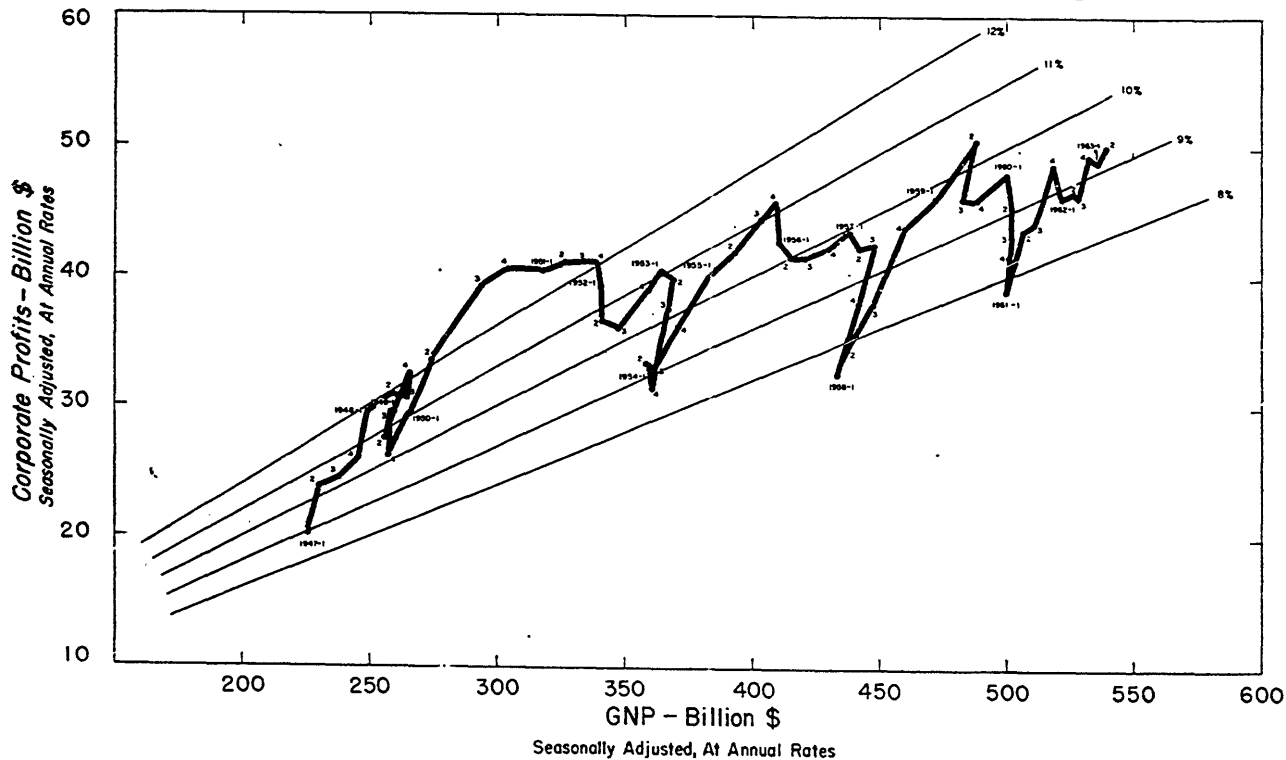
The reduction in individual income tax rates, especially decreases in the high brackets, will also provide additional incentives to take risks. The top rate will be cut by 23 percent—from the current maximum of 91 percent to a maximum of 70 percent. The current top rates are a legacy of the wartime tax system, and were designed to spread, equitably, the sacrifices necessary in support of the war effort. Today, this legacy is a drag on the willingness of many individuals to take investment risks. While the expected rate of return is by no means the only motivation inducing individuals to take risks or use their resources to the utmost, it is certainly an important stimulation. The proposed lessening of the burden imposed by the top tax brackets will encourage many investors to undertake new ventures. This greater spirit of enterprise will benefit the economy as a whole. Moreover, the present high tax rates induced too many individuals to waste efforts in trying to avoid the tax burden.

Let us go back, and look more closely at the way an increase in demand for goods and services resulting from a tax cut will lead to increasing business outlays for plant and equipment. Reduced taxes would first generate more jobs in the production of consumer goods. Later, the expanded market and increased profitability will lead to the expansion of capital goods.

However, new plant and equipment will be bought by firms only if the firms have the necessary funds available. Profits are the principal source of funds to finance such investment. A dozen years ago, in 1950 and 1951, corporate profits exceeded 12 percent of GNP; since that time, they have tended to decline in relation to GNP. Since 1950, they have fluctuated virtually between 8 and 10 percent of GNP. In fact, even in the second quarter of this year, when corporate profits rose to a near record high rate of \$50 billion (national income account basis) they comprised only 8.6 percent of the GNP. In other words, recent increases in profits even though good, have not been sufficiently large compared to increases in GNP to bring the ratio back to that in earlier postwar years. This deterioration in profits relative to GNP reflects, basically, both increasing costs and greater competition not only among domestic producers but also foreign producers.

Stimulation of demand resulting from the enactment of tax cuts should yield a pattern of profits typical of early recovery periods—i.e., they should increase quite substantially. This expectation is based on the evidence shown in chart 2 and table 2. This evidence shows clearly that profits tend to rise along with an expansion of GNP.

# CORPORATE PROFITS RELATED TO GNP IN THE POSTWAR PERIOD



Note: Data are quarterly, seasonally adjusted at annual rates; Corporate Profits are before taxes and include inventory valuation adjustment  
 U.S. Department of Commerce, Office of Business Economics

TABLE 2.—Corporate profits related to gross national product in the postwar period

[Billions of dollars, seasonally adjusted at annual rates]

	GNP	Corporate profits <sup>1</sup>		GNP	Corporate profits <sup>1</sup>
1947:			1955—Continued		
1st quarter.....	226.0	20.2	3d quarter.....	403.4	44.4
2d quarter.....	230.0	23.8	4th quarter.....	408.9	45.8
3d quarter.....	235.6	24.5	1950:		
4th quarter.....	245.1	26.0	1st quarter.....	410.6	42.7
1948:			2d quarter.....	415.0	41.5
1st quarter.....	249.5	20.6	3d quarter.....	421.0	41.6
2d quarter.....	257.7	30.9	4th quarter.....	430.0	42.3
3d quarter.....	304.0	30.6	1957:		
4th quarter.....	265.9	32.4	1st quarter.....	438.5	43.5
1949:			2d quarter.....	442.1	42.2
1st quarter.....	259.8	20.0	3d quarter.....	448.3	42.5
2d quarter.....	256.4	27.0	4th quarter.....	442.3	38.4
3d quarter.....	258.8	20.6	1958:		
4th quarter.....	257.0	26.2	1st quarter.....	432.0	32.5
1950:			2d quarter.....	437.2	34.4
1st quarter.....	265.8	20.4	3d quarter.....	447.0	37.9
2d quarter.....	274.4	33.5	4th quarter.....	460.6	43.8
3d quarter.....	293.2	39.2	1959:		
4th quarter.....	304.3	40.6	1st quarter.....	472.0	46.1
1951:			2d quarter.....	487.8	50.5
1st quarter.....	317.8	40.4	3d quarter.....	482.7	46.1
2d quarter.....	326.4	41.1	4th quarter.....	488.5	46.0
3d quarter.....	333.8	41.2	1960:		
4th quarter.....	338.1	41.1	1st quarter.....	500.4	47.9
1952:			2d quarter.....	504.1	45.2
1st quarter.....	341.0	39.1	3d quarter.....	503.5	43.2
2d quarter.....	341.3	36.6	4th quarter.....	502.1	41.5
3d quarter.....	347.0	36.0	1961:		
4th quarter.....	358.6	38.9	1st quarter.....	500.4	38.8
1953:			2d quarter.....	512.5	43.6
1st quarter.....	364.5	40.5	3d quarter.....	521.0	44.0
2d quarter.....	368.8	39.8	4th quarter.....	537.8	48.6
3d quarter.....	367.1	37.6	1962:		
4th quarter.....	361.0	31.4	1st quarter.....	544.5	46.1
1954:			2d quarter.....	552.4	46.5
1st quarter.....	360.0	32.5	3d quarter.....	556.8	46.1
2d quarter.....	358.9	33.3	4th quarter.....	565.2	49.3
3d quarter.....	362.0	33.0	1963:		
4th quarter.....	370.8	36.1	1st quarter.....	571.8	48.8
1955:			2d quarter.....	579.0	50.1
1st quarter.....	384.3	40.3			
2d quarter.....	393.0	41.0			

<sup>1</sup> Corporate profits are before taxes, and include inventory valuation adjustment. Data beginning 1962 reflect the new depreciation guidelines issued by the Treasury Department July 11, 1962, and the investment tax credit provided in the Revenue Act of 1962. U.S. Department of Commerce, Office of Business Economics.

The proposed tax reduction will help us ease our balance-of-payments difficulties. We must recognize that, for any nation, the first requirement for success in this area is the maintenance of a growing and strongly competitive economy. This tax will, with other tax measures already taken, have the effect of increasing the incentive for U.S. industry to expedite the installation of new, more efficient, equipment in U.S. plants, and develop new products and production techniques. In the area of world trade, this is exactly the road we must take if we are to stay ahead of our foreign competition, both in our home markets and abroad.

At the same time, we can expect that any strong expansionary force in our economy will, as usual, raise our purchases of foreign goods. This means that to be competitive in exports, we must guard against any upward pressures on costs and prices that would tend to raise our prices to a point where we would dissipate the long-run gains we can achieve through enhanced productive efficiency.

Beyond the effects on our trade, we would expect the effects of this tax bill to help us significantly in the area of capital flows. This should come about as we find our economy moving strongly upward, absorbing the investible funds of Americans at home rather than abroad, and bringing in larger amounts of foreign funds as investors abroad respond to our more promising economic out-

look with higher returns from investment. This tax bill would be especially effective under present circumstances when there is some evidence that returns on investment in Europe are declining as costs rise in those countries.

We are in a testing period in our international affairs, and we must demonstrate that we can take the measures necessary to develop industrial efficiency, compete strongly in all markets, and make our country the most attractive in the world for investors. Those countries that have been able to accumulate the reserves that are the counterpart of our deficits have been countries with strong growth rates and incentives to industry.

As we are able to promote larger and more efficient production of competitive goods in the United States, we can pursue much more effectively the programs we now are urgently pushing for bringing into export markets the many firms who have up to now been indifferent or believed they could not compete abroad.

Let me conclude my statement, Mr. Chairman, by referring to an argument I have heard against this tax cut which is highly misleading. This argument focuses on the transitory deficit which would be created in the Federal budget by a tax reduction unmatched by a decrease in Government expenditures. Some people seem to believe that if we do not reduce taxes we will not have a deficit. Actually the exact opposite is probably true.

We already have a deficit in the Federal budget. If we do not reduce taxes, the economy will continue its sluggish pace, and the deficit will remain with us. Moreover, without the tax cut, business may well slide off into a recession. If this happens, not only would output and employment drop but the existing deficit in the Federal budget would become even larger and far exceed the temporary increase in the deficit which this tax reduction will produce. This unpleasant prospect is amply illustrated by the experience in fiscal 1959. The previous administration anticipated a budget surplus of \$500 million at the end of fiscal 1959. It was greatly disappointed. Instead, the Federal Government ran a deficit of \$12.4 billion—the largest peacetime deficit in our history. We all know what happened. Because of the 1958 recession, the Federal Government's revenue shrank by \$6.1 billion. At the same time, administrative budget expenditures jumped by \$6.9 billion because of the rise in unemployment compensation, welfare payments, and public works. In addition, there were increases in trust fund expenditures for social security and the highway program. In order to offset some of the hardships created by the recession, these expenditures had to be increased. During the next fiscal year, however, reflecting improved economic conditions, the Government's revenue climbed by \$10 billion and expenditures decreased by almost \$4 billion. The net result was a surplus of \$1.2 billion—in sharp contrast to the unexpected and unavoidable deficit of over \$12 billion in the previous year.

Mr. Chairman, we should not have to learn this lesson again: A recession or continued sluggishness in the economy would produce a sizable deficit in the near future even without a tax reduction. With a tax cut, however, we have a chance to launch a new period of vigorous economic growth. We give ourselves a better chance to create the job opportunities sorely needed to reduce our persistent unemployment.

We can, by reducing taxes of the Federal Government, give to consumers and businessmen a new feeling of confidence in the future instead of continually burdening them with higher and higher taxes at Federal, State, and local levels. We can expand consumer expenditures and further improve our living standards. We can provide businessmen with the incentives to modernize facilities and help make our goods more competitive in world markets. And this increased competitiveness will help us solve our balance-of-payments problem.

Thank you, Mr. Chairman.

The CHAIRMAN. The Chair recognizes Senator Carlson.

Senator CARLSON. Mr. Secretary, we were unfortunately called to the floor. I did not quite conclude yesterday. I want to ask a few questions this morning. You seem to be quite refreshed.

When you originally recommended a 5-percent floor on itemized deductions, the charge was made that this injured primarily the middle income group. Now, as I understood your statement yesterday, of course you would have changed that view. You are not recommending a 5-percent across the board at the present time.

**STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE  
TREASURY—Resumed**

Secretary DILLON. No. We found that there was a general feeling that it would cause great difficulties for charitable enterprises and reduce charitable giving and harm homebuilding and a number of things of that nature that are important. We think that was probably a misunderstanding on the part of the general public. We do not think that it really would have had that effect. But since that was the universal belief, we have decided that the approach did not appear feasible, and we are no longer recommending it.

Senator CARLSON. In this legislation, would not the denial of State and local income taxes have somewhat the same effect on, I would say the middle income group?

Secretary DILLON. The State and local tax deduction I think is a totally different matter, and the proposed change is a very useful simplification and improvement in the tax laws as well as being a revenue raiser. It does not harm any industry or any occupation such as charitable giving, charity, churches generally. It does not harm home-building. It harms nobody.

Under the present system we have a very mixed-up situation with these special State taxes. In the case of State cigarette taxes, they are deductible from Federal income tax in about half the States, and in the other half of the States they are not deductible because of the differences in the way a particular State's law is written.

The same thing is true regarding alcoholic beverage taxes except that they are deductible in a smaller proportion, maybe in one-third of the States, and not deductible in two-thirds. There does not seem to be any justification for that.

In the case of gasoline taxes, over 95 percent of gasoline taxes are dedicated to building and improving highways. There does not seem to be any fundamental difference here between these taxes and the toll charges that are levied by various States for the use of highways that they have built and these toll charges are not deductible and never have been deductible. In addition, some States do not allow the deduction of their own State gasoline taxes when they have income taxes. A number of them do.

These are very difficult areas to figure because the average taxpayer cannot keep adequate records to know exactly how many cigarettes he has bought or smoked or how many gallons of gasoline he has bought and where. If he buys it when he is on a trip he may not have the records. Generally these are just estimated roughly. This causes difficulty with the Internal Revenue Service which has to audit these things. It leads to a lot of argument with the individual taxpayer, and it would be a great simplification as well as a substantial revenue raiser to eliminate the deduction of these particular special taxes.

Naturally the effect of this comes where there are the most taxpayers, and the greater number of taxpayers is in the area of \$5,000 to \$10,000 or \$10,000 to \$20,000. But the amount is so small for any individual taxpayer that it could not be said to be any hardship at all, in view of the very substantial reductions that are in the same bill for these same taxpayers.



It has always been clear that to the extent we do not recoup revenues, we would have to increase the rates. We could not have the same rate reduction. That was done in the House. The rate reduction is not as great as we originally recommended. But it was the feeling of a bipartisan majority of the House committee that these taxes should and could be usefully eliminated as deductions.

Our main reason, as I said earlier, for abandoning the 5-percent floor was not simply that it had its main weight on the middle income area. I do not think it did. I think it had its main weight on the upper income areas, although it did have some differences and some impacts in the middle income area. Our main reason for abandoning that proposal was the general feeling that it would decrease charitable giving, hurt churches, and also hurt construction and homeowning, which are things that are basic national policies. This we did not want to do. I think the House provision is in quite a different category, and we would strongly urge that it be accepted.

Senator CARLSON. Mr. Secretary, as I understand this bill, it permits the deduction of property taxes, income taxes, and general sales taxes in State and local places, but not taxes like the gasoline tax, auto registration, and alcoholic beverage tax.

I have a table before me. Of the \$520 million of revenue which you would obtain or expect to obtain from this source, according to the table before me, \$330 million of this would be from the automobile users.

Now, how can we go out and explain to the automobile users that there is placed an additional tax on them? They are carrying all kinds of taxes now, in fact more than I think they should.

Secretary DILLON. The only reason for this is that this tax, the tax we are talking about, consists of State taxes on gasoline. These State taxes or registration fees are dedicated and used to build highways for the personal use of the people driving on them. In our tax law we do not allow comparable deductions. For example, we do not allow deductions for the ticket you have to pay to go into a State park to use it. But no gasoline tax is being used that way.

We do not, as I have pointed out, allow deductions for the tolls that are paid to State highway authorities for toll roads when they are paid on a personal basis, and these taxes are identical in nature. There seems to be no good reason why they should not be treated similarly.

There is also the problem of estimation, which is very difficult. In the other areas, property taxes, not only do they enter into the question of home ownership and constitute the basic source of local revenue, but the Government knows exactly what the taxes are. Records are easily and readily available.

On general sales taxes, the same thing has been practical because the Internal Revenue Service has been able to work out, based on income of individuals, a series of tables which show what their general purchases should be at various income levels, and that is what they allow for general sales taxes, and there is not much argument about that. But in this other area, it is an area where there is substantial evasion of taxes, and it is very difficult to be sure you are accurate.

So I am sure in many cases Internal Revenue agents, in trying to be fair, may be overfair and disallow things that under the law

probably should not actually be disallowed. So therefore, it seems much more clean cut to eliminate this.

Senator CARLSON. The State of Kansas, Mr. Secretary, is at the present time collecting 9 cents a gallon tax on gasoline. Present indications are that they may increase it a cent and a half at the next legislature, because I think the State, like I noticed the Federal Government now, thinks they are just another easy source of revenue, "We will just put an additional burden on the people that use the automobile."

In the State of Kansas the use of this is limited for the construction of highways.

Secretary DILLON. I understand that is right.

Senator CARLSON. Now this \$320 million would be revenues of the Federal Government; is that not true? It could be used in any way that the Government decides to use it. It is not just for building roads?

Secretary DILLON. Oh, no. This would be general revenue. It would arise from the elimination of deductions for these taxes.

Of course, as you know, the States do not allow deductions in their income taxes for Federal gasoline taxes. They do not allow deductions for any Federal taxes of that nature. So there is no reason why this should be allowed.

Of course, you understand, I am sure, that this does not apply to the business use of vehicles. Any business expense that is necessary in the ordinary course of business, which would include gasoline, wear and tear on the car or anything else that is used would continue to be deductible as always.

Senator CARLSON. In regard to the deductions for the gasoline tax, you stated one of the reasons you thought this would be most helpful, it would be a great simplification. I can conceive where it would be most difficult to administer this if you began to make separations, as you say you are going to do, between the use of gasoline for business and industry and then for general use on the highways. I could see where you would get a great administrative problem.

Secretary DILLON. None whatsoever, Senator, because that difference is already there today, and so it is exactly carrying on the law as it is. There would be absolutely no difference.

I think it is rather interesting. We did make some computations that would show what we are really talking about for a taxpayer who drives an average of 15,000 miles a year on his own, based on a State gasoline tax of 6 cents a gallon. You can increase that if one wishes to take care of the higher taxes. In a taxable income bracket of from zero to \$4,000, the lowest bracket, the average increase in tax for driving an American compact car would be \$9.60 in a year, and for someone who is in a slightly higher bracket, the \$12,000 to \$16,000 bracket, it would be \$14.40. So this in no way is a burden because the reductions that are being given in other taxes by reducing rates so far outweigh this, there is no comparison.

The individual automobile owner and driver, since most everybody owns cars these days, would not be any better off because we would simply have to increase the tax rates to get this \$500 million back some other way. So instead of paying it with one hand, he would

be paying it with the other. There is absolutely no difference, but just a simplification of the law, and I think a useful one.

Senator TALMADGE. Will the Senator from Kansas yield at that point for a question along the same line that the Senator is pursuing?

Senator CARLSON. I yield.

Senator TALMADGE. Mr. Secretary, as I understand the bill, it authorizes the deduction of the personal property taxes on the car, but does not authorize the deduction for his license fee or his tag fee; is that correct?

Secretary DILLON. That is correct.

Senator TALMADGE. Now, are there any States that have a combined license fee and property tax or where two would be indistinguishable?

Secretary DILLON. I think that in those cases where they are combined, we would allocate between the personal property tax and the license fee. I think there are a number of them where they are valued on the value of the car. In that case it is all right.

Senator TALMADGE. Both of them would be deductible then?

Secretary DILLON. It would be deductible, but where they are separable and not indistinguishable, there is a provision to allocate between each part.

Senator TALMADGE. Do you not see a danger in this in that many legislatures, in a desire to help the taxpayers as their constituents, would probably pass similar legislation and make the whole thing deductible, the license fee and the property tax?

Secretary DILLON. In those States where they generally tax the ownership of cars as personal property, the taxation is somewhat heavier than it is where it is just a straight license fee, and if the State wanted to increase their revenues from that source, they might do so.

Senator TALMADGE. I thank the Senator for yielding.

Senator CARLSON. Mr. Secretary, I raise this issue because I think you have selected a group of taxpayers that you thought we could just collect \$320 million from, and it is a large item, it would not be too noticeable on any individual one. Of course, when you begin to add them up, it just seems to me that we have placed a burden on this group that should not be placed on them at this time.

Is it not true that also in this bill you are limiting the deductible on some of these casualties to \$100? In other words, if I have a car wreck and my bill is \$150, all I can deduct is \$50? If I have an accident, somebody bends up a fender, and the bill is \$150, I cannot deduct but \$50; is that not correct?

Secretary DILLON. That is correct for casualty losses. It follows the precept which the President recommended, that casualty losses should only be considered when they are something extraordinary and not in the ordinary course of living expenses. We had originally recommended a percentage floor. The House preferred a flat figure, and that particular provision I think was adopted unanimously with no opposition at all, because it seemed obvious that what we are really trying to do is to protect an individual, a taxpayer, from a sudden and unexpected catastrophe that comes in and overwhelms him. We are not trying to give him a subsidy for his ordinary day-to-day expenses, which occur every time he happens to nick another fellow's fender

and have a paint job for \$5.60. So this is the idea behind that \$100 floor.

Senator CARLSON. That section of course goes much further. I just mentioned an automobile fender because we were talking about automobiles.

Secretary DILLON. It talks about all casualties.

Senator CARLSON. In other words, if you have a flood damage through an area, and quite often these flood areas are in the very low income sections of a city, those people will not be permitted to deduct the full amount for the loss of their furniture? They would get a \$100 item—

Secretary DILLON. They would have a \$100 floor there. They would be allowed to deduct anything over \$100, and if they had any substantial flood damage, the damage would be over that.

Senator WILLIAMS. Will the Senator yield at that point?

Senator CARLSON. I will be happy to yield.

Senator WILLIAMS. About a couple of years ago we had a similar experience in that connection over in our area where a lot of the people back about 10 miles from the coast had their homes flooded and most of their damage averaged from \$100 to \$300 where they flooded the living room, damaged their furniture in one room or something. As I understand it, they would be eliminated on the first \$100.

Secretary DILLON. The first \$100; that is right.

Senator CARLSON. Mr. Secretary, while we are talking about the effect on deductions for State taxes of various types, in your statement to the committee you mentioned in regard to the needs for States to get additional taxes, additional tax sources—well, having served as the Governor of a State I am somewhat familiar with the demands of a State for education, social welfare, highways, and it is a continuing pressure. There is not any question about it.

The legislatures are confronted with that. I ask you this. You mentioned the fact that if we reduce the Federal tax, it would give the States an opportunity to pick up additional sources of additional revenue.

Well, would that not offset any effect of a Federal tax reduction or whatever percent it was increased as far as improving the economic condition of the country is concerned?

Secretary DILLON. No; I do not think that is a valid argument, because I think that States will increase their revenues as they need them to meet the obligations that fall upon the State, and may be approved by the voters of the States. I think in many cases the States have to approve bond issues or have to approve new special taxes by referendum.

I think those tax increases will take place in any event. What will happen here is that by increasing the general level of the American economy, the general prosperity of the economy of the country, the general income through the country will be higher. We prepared a statement at the request of the chairman of the Joint Economic Committee, the Senator from Illinois, who is a member of this committee, to see what effect this general increase in economic activity would have on State and local revenues. I think the figures came out that with no change in the present State and local tax systems, there would

be an increase of about \$2.9 billion in the revenues available, divided about half at the State level and half at the local level.

This would be without opening up new sources of income, but this would just be greater receipts than the existing sources of income, because of greater economic activity.

Actually, many States counted on that. I know that in the State of Minnesota, the Governor submitted a budget that was counting on increased revenue, and in the great State of New York the Governor made a statement recently that he was unable to balance his budget, to do as well as he expected, because the general economy of the country had not advanced enough.

Well, that is just what we are talking about. If the economy advances, more revenues would come in to the State governments without changing their present tax system.

Senator CARLSON. Assuming they do not come in, and I think it is generally agreed that every State is going to have to increase its taxes—I do not know any State that does not have to have increased income because of the increased demand.

The point I was getting to I hope is this. If States collect an additional billion dollars in revenues, does that not offset a billion dollar reduction that you give here in this bill?

Secretary DILLON. As a general economic matter, if the States collect \$1 billion more, it is a billion dollars extra tax burden on the economy, and it does have a repressive effect. However, all I am saying is that there is no connection between the two. The States are going to raise money in any event if they need it, and if they do not need it, they are not going to raise it.

So to the extent that we pass this bill, the economy, the general tax-load will be \$11 billion less in any event, irrespective of what the States do.

Senator CARLSON. I can assure you that the States are going to increase their tax burden.

Secretary DILLON. Yes; I am sure of that too.

Senator CARLSON. If I know anything about State government.

One other item that I want to dig into just a little bit. You mentioned it in your statement.

I think in order to introduce it I will just read your own statement, and I quote:

Some people have criticized tax reduction on the ground that the temporary increase in the budgetary deficit that would flow from the enactment of H.R. 8303 would pose an unacceptable danger of inflation. This criticism is based upon an erroneous view of the cause of inflation. Whether inflation occurs depends on the state of the whole economy, not just the Federal budget. It can be due either to an excess of demand on the supply or to a situation where costs of production rise more rapidly than productivity.

For the past 5 years neither type of inflation has been present in our economy. Wholesale prices have stayed level since 1958 and wage increases remain within the bounds of the improvement in productivity. At present our economy is marked not by inflationary pressures, but by unused plant capacity and unemployed workers.

I would ask this question: How much inflation have we had during the past 5 years, just roughly?

Secretary DILLON. I do not know how one can measure that. Measured in terms of wholesale price index, which covers all the goods and

services we produce, we have had none whatsoever. This is the index which is relevant when we are considering our competitiveness in world markets, exports, things like that. The price index is steady. Measured in terms of Consumer Price Index, the index has risen in the period from 1958 by about 7 percent, the larger part of this increase being in the area of services where productivity cannot keep pace with advancing wages.

Now there is a lot of questioning among experts. The Consumer Price Index does not take full account of improvement in quality of goods purchased and services available, and I think there is a general feeling that that is a highly good record and would not be called inflationary in any degree. Certainly it compares well with European countries, many of which in recent years have been having consumer-price increases of that much every year instead of over a 5-year period.

I think it is the best record of any country in the past 5 years, any industrial country in the world, with the possible exception of Canada, which has an almost identical record. Their economy is operated very similarly to ours.

Senator CARLSON. Admitting that we had not had great inflationary pressures in the marketplace, although I think some retail prices have gone up considerably—

Secretary DILLON. Some have gone up, some have gone down.

Senator CARLSON. Does it not concern you that we now seem to be entering a period of increased prices in most commodities just across the board.

I have here a listing and I do not want to take the entire time of the committee.

I note the Secretary is familiar with these, but I think for the record steel, for instance, last week increased their prices by \$6.50 a ton on steel pipe, and the average has been up about \$4.50 for the entire year.

Aluminum is up to 23 cents a pound. That is up one-half cent.

Lead is up  $1\frac{3}{4}$ , zinc up 1.

These are all components, that is, this is all basic in the industrial field.

Then we get into food commodities.

Sugar is going up. Yesterday I noticed that raw sugar was 9 cents plus on the Wall Street Board of Trade. No, that was on the cash market. A year ago it was 6.

Coffee is going up now 2 cents a pound, and we had some discussion of that in the committee before when we reached the international coffee agreement. A 1 cent increase in the price of coffee is a \$35 million burden on the consumer in the United States.

Cocoa is up several cents a pound, wool is up 3 cents, furniture is going up 4 percent, men's clothing is up about 4.

It just seems to me, Mr. Secretary, that we are right on the verge of an across-the-board increase. So while we talk about the past, I think we ought to look a little to the future.

Secretary DILLON. I think that there has been some publicity about that, and of course every industry and every price, particularly if you take basic commodities, have special problems of their own.

For instance, sugar has nothing to do with inflation or noninflation in the United States. It is due solely to the collapse of the sugar-

producing industry in Cuba, and the fact that their production is several million tons less than it had been before the Castro regime came to power. That has led worldwide to a very sharp increase in the price of sugar, until there is time to plant additional supplies in other parts of the world to catch up and bring sugar production back into a better balance.

Now some of these other things that you mention, for instance, lead and zinc, there have been efforts through international commodity meetings to hold down the production of these metals in other foreign countries so that excess stocks would be used up and the price could get back to what is considered a price at which it is possible to work the mines. The increases in this country have been—and those are world prices too, on lead and zinc, have been about 2 cents a pound, but they have not yet been enough to open a single new lead or zinc mine in this country. So it shows they are just returning to more or less normal circumstances.

In other products there have been reductions too, but we get much more publicity about the increases.

I would certainly agree that prices today, because business has been reasonably good over a period of 32 months now, are firmer than they were a year ago. But it does not yet show through in price indexes.

The latest price index, the wholesale price index of all commodities by the Bureau of Labor Statistics shows that prices in August were 100.4 percent of the 1957-59 average, which is practically no change. In 1958 they were 100.4 also. That is a little higher than the low. They reached a low this year in the spring of 99.7 percent, but it is no substantial increase. Actually, in August they fell as compared to July.

So I think the general estimate is that there is no reason to fear an inflationary price push at this time, but this is something that we have to watch. We have to watch it as far as industrial price increases are concerned. We have to watch it as far as wage increases are concerned so that we can maintain this price stability which is so important to our balance of payments. We think we can do that.

Senator CARLSON. Not only the inflation in our country affects us, it affects the consumer purchasing power, but, as you just mentioned, the balance of payments enters into this, too.

There are some economists that contend that a 2-percent rise in prices spread throughout the economy would wipe out all the increased demand that the tax cut is designed to create. What is your comment on that?

Secretary DILLON. That is a technical thing for economists. I do not think that works that way at all, because if prices go higher, it means other people, someone has to pay more, but the man on the other side also receives more, and the economy is operating at a higher dollar level, and certainly if it is producing more goods and services, it has not wiped out the advance.

But I would much prefer to leave a detailed discussion of that rather abstruse subject to the Chairman of the Council of Economic Advisers who would be prepared to answer you fully on that subject.

Senator CARLSON. I realize we have economists and economists, and they do not always agree. They have different viewpoints.

Recently a Swedish economist has written a book. I glanced through it, I have not read it. It is entitled, or headed, "The New American Dilemma," and it is economic stagnation. His name is Gunnar Myrdal.

I suppose because of my nationality I would probably have a little more faith in him. He questions seriously the possibility of increasing production through tax reduction, particularly eliminating unemployment. He rejects, and I will quote a sentence here:

The implicit assumption that an increase in production will mean an increase in employment and a decrease in unemployment.

You have discussed that I know, but it is an interesting comment from some people who have had some experience in a nation that seems to have full employment.

Secretary DILLON. All I can say to that is that the American Federation of Labor and the CIO would probably know as much and have as close an interest in employment as any body of men in the world and take a totally opposite view to Mr. Myrdal. They do feel that this tax reduction will substantially stimulate the economy and will provide millions of extra jobs, and they have just so stated in a resolution they passed about a week ago out in Colorado Springs, I think it was, where they were meeting.

So as you say, economists have all sorts of ideas but it seems to me commonsense that if we produce more and people are paid more for that extra effort in producing it, there is more income in the economy, that they will spend this and that that will make more jobs. I just do not see how you can avoid that conclusion as a commonsense matter.

I think you can argue about the number of more jobs, and there I do not have a particular opinion. I certainly do not think that this tax cut alone will solve our entire unemployment problem, but it will create an atmosphere in which the other efforts toward better labor training and labor mobility, which are so important, can work better than they do at present.

Senator CARLSON. I think everyone, of course, is concerned about the unemployment problem, and I sincerely hope that we can accomplish it in some way through reduction in taxes or through some other program. But I have grave doubts personally that it is going to do it. In fact, we have no past history in this Nation which we could look to and say that a tax reduction did certain things as far as unemployment is concerned, have we?

Secretary DILLON. I think that the tax reduction of 1954 helped to stimulate the economy through 1955, 1956, and 1957, and that was the last time at which we reached full employment. Since then we have not had full employment. We have had this continual excess unemployment, and this is a somewhat new and different situation.

But what we are trying to do is not unique at all in the world. The British Government, which is a conservative government, adopted the same policy and cut taxes drastically—based on the size of their economy it was a slightly larger cut than this—last spring. They made this recommendation, and because of their system the law was enacted much more rapidly than it could be here, and became effective in about 6 weeks to 2 months. The result, almost immediately, has been a very sharp drop in their unemployment. This had a very direct effect on



employment statistics there, which certainly would lend encouragement and support to the argument that it would do the same thing here.

Senator CARLSON. Of course we could get into a discussion of that, which I shall not do at this time, but I was interested, having attended the parliamentary meeting in Bermuda with representatives of the British Parliament and several Members of our own Senate, to find that they made some trades that brought a lot of labor to Great Britain.

For instance, they build ships for Russia in return for getting oil, and many of those items which have nothing to do with taxes, and one I think we have got to give some thought to for our international trade programs in the future.

That is all, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Secretary, ordinarily what many of us do here goes virtually unnoticed, and even if noticed at the time is soon forgotten. Since my position with respect to the pending bill has been under severe attack and is a matter of controversy, it will be necessary for me to make some preliminary remarks and ask you a very few questions on a matter which is of no major significance to the country but which is, I hope you will understand, of great significance to me.

Some commentators have been referring to my sudden change of position with respect to the basic issues involved in this bill. Since you were a member of the administration of former President Eisenhower, perhaps you will recall that President Eisenhower recommended—and I think he is entitled to great credit for recommending—the great interstate highway program that is now underway. He recommended that it be financed by debt, by the sale of bonds.

I opposed this. And through my efforts and those of Senator Byrd and other members on both sides of the party aisle, we put the highway program on a pay-as-you-go basis. It is a little behind schedule now, but we are soon approaching the time when, on a pay-as-you-go basis, the trust fund will be solvent and highway construction on schedule. I cite this to show that I am not just suddenly seized with some concern for fiscal responsibility.

Now I know you will understand from my record that I am not one who thinks that it is either wise or necessary to have a balanced budget each year. Others may feel more strongly about that than I do. But I would like you to know that it is my view that we cannot ignore debt.

When I came to Congress, the entire national budget for all purposes was less than \$10 billion. What will be the amount of the item in the 1964 budget for payment of interest on the national debt alone?

Secretary DILLON. The payment is about the same, about the same figure as you mentioned, about \$10 billion.

Senator GORE. The entire budget in the spendthrift days of the Roosevelt New Deal when I came to Congress was less than \$10 billion. The interest on the budget which you and the President have presented for fiscal 1964 is something more than \$10 billion, is it not?

Secretary DILLON. That is right.

Senator GORE. Debt service charge.

Now, how has that interest item increased during your service as Secretary of the Treasury?

Secretary DILLON. In the 3 years from 1961 to 1964, our estimate showed an increase of something over \$1 billion. This compares to an increase of about \$1.4 billion in the 3 years preceding that, so in the last 6 years there has been a very substantial increase.

Senator GORE. Now, as I examine here the Economic Report of the President, I find that if you eliminate expenditures for national defense, Veterans, and Agriculture, the interest on the national debt equals almost half the cost of all other Government services combined—highways, public health, cancer research, education, name them all.

I cite this to illustrate that I am not suddenly concerned about fiscal responsibility. I think it is something to which all of us who are privileged to serve in public life must give constant heed.

I take it you agree, too, with that.

Secretary DILLON. Very much so.

Senator GORE. Now, Mr. Secretary, no one is more aware, than perhaps the President and I, of the degree and intensity of my disagreement with your fiscal, monetary, economic, and tax policies than you are. You have been aware of it a long while have you not?

Secretary DILLON. Yes, sir.

Senator GORE. So you are not suddenly surprised? You have no sudden surprise at my position?

Secretary DILLON. No. I am well aware that for over a year you have made your position clear that you did not feel a tax cut was advisable in present circumstances.

Senator GORE. I am not sure you were aware of it before you became Secretary of the Treasury, but with every ounce of strength I had, I opposed your selection as Secretary of the Treasury.

Secretary DILLON. I have been informed of that.

Senator GORE. You understand there was no personal quality in that?

Secretary DILLON. I recognize that too; yes, sir, very much.

Senator GORE. I have found you most agreeable and genteel, though I find your philosophy utterly unacceptable. Of course, you and I have found one or two things we could work together on. We tried to put a stop to the use of foreign tax havens. We worked together on that. We had partial success, though not too much. There are a few things we have been together on.

Secretary DILLON. And also on what you mentioned earlier, putting the highway system on a sound financial basis. That was one of the first recommendations we made and we were successful, as you recall, in 1961 in getting the bill passed—

Senator GORE. Wait a minute.

Secretary DILLON. That raised taxes applicable to that and put that on a sound basis.

Senator GORE. I am not going to let you take credit for that. We did that before you became Secretary of the Treasury.

Secretary DILLON. No, sir; no, sir.

Senator GORE. Well, we passed an additional bill I understand.

Secretary DILLON. You did about 80 percent and we did the last 20.

Senator GORE. All right, I am willing to go along with you to the extent of 20 percent.

Getting back to the question of your selection to head the Treasury, I visited for about 2½ hours with President-elect Kennedy when he was still in his home in Georgetown. I undertook to persuade him not to select you or someone of similar philosophy as Secretary of the Treasury. Like Dr. Heller, I put up a good argument, but I did not seem to win any decision.

I wrote the President on November 22, 1960—I am not going to make public all my correspondence with the President, but I set down in writing my views. I fear the letter is too long to read. It does not contain any personal reference to you of a derogatory nature in any way. I would like to read this one paragraph:

The appointment of such a person as Secretary of the Treasury would mean, for instance, that glaring tax loopholes would not be closed, that fiscal policies, monetary policies, and economic policies would not be very different from the present administration. This would not be your intention, to be sure, but it would be the likely consequences.

This was dated November 22, 1960. The only change in that paragraph I would now make is to strike out the word "likely."

On June 28 of 1962 I wrote the President as follows:

I know that there are certain interests and persons who would like to get tax reductions now and quickly because, after this is done, their loopholes would then be perfectly secure.

That is what they are about to get now without the closing of loopholes.

A drastic reduction in Federal revenue would put your administration in an economic straitjacket and deprive it of the ability except at greater deficits to stimulate the public sector of our economy where rests, incidentally, the real pent-up needs and demands of our economy.

Then on November 15, 1962, after the President and I had had a conversation on the sad occasion of the burial of Mrs. Roosevelt, he asked me to write him a letter setting out my views. I will not read this in full, but I would like to read part of it, not particularly for your benefit, but for anyone who is interested and who thinks that I have suddenly found myself in disagreement with the Dillon economic, monetary, and tax policies.

I have come to admire your ability, Mr. Secretary. There are few men I know who have quicker and keener minds than you have, and I must say that I am amazed and alarmed at the extent of your success in subverting the traditional economic liberal policies of the Democratic Party, particularly at the Washington level. I am not sure it reaches too far out to the country, and I would suggest to you, and to those with whom you consult and advise, the old political axiom that when the country votes conservative, it votes Republican. I do not know whether that would be agreeable to you or disagreeable.

Senator LONG. Mr. Chairman, I believe that before the Secretary hears any more of a speech, and the Senator certainly has a right to make his position clear to the record—

Senator GORE. I did not yield.

Senator LONG. That the Secretary is entitled to answer whether or not he has opposed loopholes.

Senator GORE. Mr. Chairman, I did not yield to my distinguished friend from Louisiana. I asked the privilege of making a brief preliminary statement, and then the Secretary can reply to whatever extent he likes. I do not yield for that purpose now.

Senator LONG. I would point out that the Secretary is a witness here.

Senator GORE. I do not yield, Mr. Chairman.

I wish now to read briefly from the letter of November 15:

Since you inquired of my views on the advisability of a tax cut, I write them. As I said to you in Hyde Park, I do not believe a big tax cut is advisable. Politically a big deficit and tax reduction are incompatible. However unsophisticated it may appear to your economic advisers and however erroneous it may be, the mass of our people tend to judge this question in the simple terms of the family budget. Moreover, a reduction in revenue will set up a howling campaign for reduction in expenditures, and your administration will be put in an economic straitjacket. The ax would most likely fall heaviest on foreign aid and on programs that may be needed to stimulate the economy, such as public works. These things, it seems to me, are as simple as A, B, C.

Now with that I close insofar as setting my own record straight before you and the committee and whoever else may be interested, Mr. Secretary.

Please let me say again that the references I have made to you have to do with a philosophical disagreement in principle and in no way do I wish to be unpleasant with you personally. Now, before going into some questions on another matter, I certainly yield—and I think the Senator from Louisiana is entirely correct in suggesting that you have an opportunity to comment.

I thought, Senator Long, if I could just finish that one more reference, which was all I had to read, then I would yield.

Thank you.

Senator LONG. If you wanted to yield to me, if you would for just a moment.

Senator GORE. Yes, I will.

Senator LONG. It seems to me it is more appropriate in examining the witness to ask whether he has recommended loopholes rather than to say, "You have not recommended closing loopholes," if the man is a witness.

Senator GORE. I did not say he had not. I did not say he had not.

Senator LONG. That is what I gained from the inference of the statement.

Senator GORE. I said his appointment as Secretary of the Treasury would mean they would not be closed.

Senator LONG. I understand that, but the Senator has yet to ask a question. He has made a speech to the Secretary which puts the witness in a very bad light, and it would seem to me if you are examining a witness you would start out by asking him a question.

For instance, have you recommended closing loopholes?

Senator GORE. Mr. Chairman, I am sure I could benefit by a lecture from my distinguished friend from Louisiana, but I do not feel any particular need right now. I started out to make a preliminary statement, which I have done, and have now afforded the Secretary an opportunity to comment. Following that I will undertake to interrogate him.

Is there anything out of order in that, Mr. Chairman?

Secretary DILLON. I would only like to make two comments I think on your views.

I have known of your general views on economic and fiscal and tax policies for some time.

Senator GORE. And monetary and credit.

Secretary DILLON. And monetary and credit policy and the whole gamut of policies.

I would like to say, when talking about closing of tax loopholes, that the record is perfectly clear that there have been recommendations made which I have fully concurred in for very substantial loophole closings. We have done our best to achieve that in the House of Representatives and in the Senate. We have not been as successful as we would like to have been. I quite agree with that, but I do not think personally—maybe I am not modest enough—that the action of the Ways and Means Committee and the body of the House in approving what they did approve and in rejecting what they did reject was because of lack of effort on the part of myself or of the Treasury. It is just that this is the opinion of that particular committee which controls tax policies in the House and which takes into consideration general views throughout the country, and they accepted a number of our recommendations and not others.

I am very glad that for the first time we were successful in getting them to accept what I consider a very important advance, which is the elimination of the dividend credit. That has been tried before, and this body, the Senate has several times voted for its elimination. The House has always rejected it. We have now got it approved by the House and I think that is a real advance. I think that the recommendation for taxation of capital gains at death is probably one of the most important changes that could have been made in the income tax, or that for a carryover basis which on a somewhat slower time scale accomplishes roughly the same thing. We came very close to success there. At the last minute the committee again decided against this. Unfortunately, in this case this was by largely a vote that involved both sides rather than one largely on partisan grounds.

There was a substantial majority of the Democratic members of the committee that were in favor of maintaining that, but they were not a majority of the committee as a whole.

The question of the best way of handling the responsibilities under the Employment Act of 1946—which is to increase employment and to give everyone who wants to work an opportunity to work—was discussed in great detail and over many months within the administration.

As the President pointed out I think in either his tax message or the budget message, there were two alternative routes. One was substantially larger expenditures and the other was to try to give that responsibility and opportunity to the private sector of our economy. That does not mean that there are no new programs, that nothing was done in the public sector, but that the main emphasis is put on the private sector rather than the public sector. A decision was taken that that was the proper course.

I recognize that decision is one that you would not agree with. There is a philosophical difference, but I may say that I think—not just myself, but under the circumstances there was unanimous agreement within the administration—that that was the proper course to follow.

We have achieved a situation where we have support, outside support, not only from business interests but also from the American Federation of Labor, as I pointed out, and also from the great majority of economists who study these matters and who make their feelings known. Certainly the Council of Economic Advisers is strongly in favor of tax reduction and has been all along.

I might say that one of the times when I differed with them was last summer when I agreed with you that a quick tax reduction, a substantial tax reduction with no effort at any reform at all, was inappropriate and bad policy.

Senator GORE. That is one time we won.

Secretary DILLON. At that time we were together and we won. And so the package that was proposed this spring had, I think, a substantial amount of tax reform. We got in a number of items, we got maybe three-quarters of what we asked for in effect, maybe a half, but we got a substantial amount, and I would say that I willingly admit a difference of view on giving the private sector of our economy the opportunity now to increase gross national product, and releasing it from the tax brake and thereby bringing us back to full employment, rather than trying to do it through increased public expenditures.

I think that the debate in the House was accurate on that point. As the chairman of the Ways and Means Committee pointed out, he felt that the tax reduction route and the spending route from the point of view of spending just to stimulate the economy were incompatible, and this was a definite choice, the choice of the tax reduction, private enterprise, route.

That does not eliminate expenditures for needed and necessary public works such as the bill—I do not know whether it was just passed or is pending, but I hope it will soon pass—that will allow contributions to building universities, because I think it is highly important and necessary that those things be carried on. But I think we are in general agreement and understanding of each other's policy.

Senator GORE. Thank you.

I am going to undertake to challenge the validity and advisability of this philosophical base upon which your policies are recommended, but before doing so I would like to inquire of my friend from Louisiana if he has any further suggestions as to subjects which the Secretary should comment upon in fairness to him.

Do you have any?

Secretary DILLON. No.

Senator GORE. Before coming to the more important things, Mr. Secretary, I feel the necessity of asking you if you have been engaged with Chairman Bailey or anyone else on the Democratic committee in an effort to send misleading information or otherwise to put the heat on me in Tennessee with respect to this bill?

Secretary DILLON. I have had no contact with Chairman Bailey or anyone else in the Democratic National Committee on this subject.

and I inquired in the Treasury to see if our Treasury staff has, and they have not either.

Senator GORE. This is exactly what I expected you to say. If the statistics contained in the telegram had come from the Department of the Treasury, I would be not only surprised but shocked and astounded.

Now, if this bill in fact practically removes Tennesseans from the obligation of paying income taxes, then I will say I must find the necessity of reexamining my position.

Secretary DILLON. It certainly does not.

I would like to make one thing clear regarding these possible figures and where they may have originally come from. It should be made perfectly clear.

Senator GORE. They did not come from the Treasury?

Secretary DILLON. The figures on increase in personal income in the State of Tennessee and in every other State of the Union, figures of that nature have been prepared in the Treasury. They were originally prepared in the Treasury as part of the necessary work in answer to a request from the chairman of the Joint Economic Committee, the Senator from Illinois, who wrote to us last spring and asked us to make a calculation based on some work that his staff had done as to what the general economic impact of a \$10 billion tax cut would be, and the assumption that he asked us to take was that there would be a \$40 billion increase in gross national product.

As part of the only way that this job could be done, it was necessary to find what portion of that gross national product was in the form of personal income, which came out to a total of \$30 billion, which is the normal relation between gross national product and personal income.

Then in order to make the calculations which we had been requested to make, it was necessary to break that \$30 billion down as well as we could into the amount of that that would be in each and every one of the States, so that we could answer the request made to us as to how much that would increase the income of the State and therefore increase its tax receipts.

This table, which I have—I will be glad to put it in the record—is available, although we did not supply that particular table to the Democratic National Committee, and they did not ask for it from us, they may have received that one figure from that table that was in someone else's hands.

Senator DIRKSEN. Will the Senator yield for a question?

Senator GORE. Yes.

Senator DIRKSEN. Has the telegram that you referred to been made a part of the record?

Senator GORE. It has.

Senator DIRKSEN. I was not aware that it had.

Senator GORE. It has.

Will the clerk give the Senator from Illinois a copy?

Secretary DILLON. That one figure could have come in that way, but it did not come in response to any request from the Democratic National Committee, either the total or the figures for Tennessee.

Senator GORE. Let me read you the first—well, let me read:

This is the suggested press release we discussed. Please have it copied and taken to all newspapers, radio, and TV stations. The release follows:

This is the first paragraph of the proposed release which I now read:

It is vital to 17,496 families in \_\_\_\_\_ County who will receive an average personal income increase of \$436 a year that the tax cut be enacted now and made effective as of January 1. \_\_\_\_\_ County businessman and Democratic leader said yesterday—

Now, I would think any citizen having read the papers, heard the radio, and watched TV on the tax bill would conclude that this average personal income increase of \$436 a year was a benefit which he was going to receive from the passage of this bill.

I have examined statistics from the Treasury and I find that this approximates the total individual income tax payments of the people of Tennessee.

Secretary DILLON. I have looked at that telegram, and the only basis on which I can figure out how the author of it reached any such figure was to take this figure which is also in there of national income increase, which I think, as I recall, was \$390 million for the whole State of Tennessee, and go to the Census Bureau and find the number of families that there were in Tennessee at latest count and divide the families into this.

Senator GORE. But he did not multiply the families.

Secretary DILLON. Maybe he did not multiply them right.

Senator GORE. You are not against that?

Secretary DILLON. I think that it comes out somewhere in the telegram, I think it also states the total number of families in Tennessee. It happened that in checking back I find that that is out of the census figures. I do not know where he got county figures. I presume maybe he got that from the Bureau of the Census too.

Senator GORE. You are not prepared to say then that the passage of this bill is going to suddenly increase the income of the average family in Tennessee by \$436 a year.

Secretary DILLON. No, sir.

Senator GORE. You are not supporting the Democratic National Committee in this regard?

Secretary DILLON. I do not think this was the Democratic National Committee either, from what I have been able to understand. I think that this was one man.

Senator GORE. Well, it may be that this one individual did it and I will be glad to find out that that is true. I hope that is the case.

Secretary DILLON. I understand that you said that you had had a discussion with the chairman of the committee, and I assumed he assured you it was not the committee's position.

Senator DIRKSEN. Mr. Chairman, could I ask the Senator another question?

Senator GORE. Yes.

Senator DIRKSEN. Since this matter was first ventilated some days ago, has there to your knowledge been any effort by the Democratic National Committee to repudiate this telegram?

Senator GORE. I have seen no public statement by any official of the Democratic National Committee except the gentleman who signed



the telegram, who is I believe head of the research division. He said that this was a part of a campaign to educate people on the tax bill.

Does that answer the Senator?

Senator DIRKSEN. Yes.

Senator GORE. Now I would like to refer to one other statistic here. This is again in the proposed press release which Tennesseans are asked to release.

They know the high rate of unemployment. In 50 of our counties the unemployment rate ranges from 10 to 20 percent.

Now I thought that was a little high.

I notice later on he refers to total unemployment in Tennessee as 57,600 people. Well, you cannot take any 50 counties in Tennessee and have as much as 10-percent unemployment and still have only 57,600 unemployed. So this is a contradictory statistic.

Secretary DILLON. It sounds so, though the Treasury is not in the unemployment statistics business—

Senator GORE. You do not validate this either?

Secretary DILLON. What?

Senator GORE. You do not validate this figure either?

Secretary DILLON. No, I would not know anything about it.

Senator GORE. Well, I called someone who did know about it. I called Mrs. Frank Scott, commissioner of employment security in Tennessee, yesterday. The first question I asked her was, "is there any county in Tennessee with 20-percent unemployment?"

She gave me an emphatic "No."

Then I wanted statistics for the State as a whole, and broken down as to county, and she said this would require some time. So Assistant Commissioner Carl Anderson called me back late yesterday, and gave me the following statistics:

In August 1963, unemployment was 51,700, or 3.8 percent.

Incidentally, this is the lowest rate it has been in quite a long while. Let me give you the previous years.

In 1961 it was 99,100, or 7.6 percent.

In 1962 it was 76,600, or 5.9 percent.

There are only seven counties with as much as 10 percent unemployed, and I was advised these were small mountain counties where coal mining has been discontinued or where strikes are underway.

In 1961 there were 16 counties with as much as 10 percent unemployed.

In 1962 there were 10, in 1963 only 7.

Now perhaps you would be interested in knowing one of the reasons why we have made such great progress in Tennessee in solving our unemployment problem.

State and county officials, city officials have been working at it, and the programs of the Kennedy administration have been enormously helpful. I refer particularly to the area redevelopment program, and to the accelerated public works program. I and my staff for the last many months have devoted intensive efforts toward securing approval of projects to build community facilities, hospitals, playgrounds, water systems, sewage disposal systems. We have secured the approval of about a hundred APW and area redevelopment projects in Tennessee. This has materially lessened unemployment, because every time a project starts, men are put to work.

Now this, Mr. Secretary, is governmental expenditure for the development of community facilities which will add to the life and the affluence of our people, and will be good for many, many years.

This leads to a question on the broader issue. If I may, we will dismiss this Tennessee angle with the national committee.

Secretary DILLON. It is perfectly agreeable with me. I did not know whether or not you wished the list which we have, the breakdown of this \$30 billion by States, which we made last spring.

Senator GORE. I think it would be well to put it in the record.

Secretary DILLON. I think it would be useful.

Senator GORE. As I understand it, it is an extrapolation based on whatever growth the national economy may experience in the next many years.

Secretary DILLON. Yes. It talks about the midsixties. It does not pinpoint any particular year.

Senator GORE. I think it ought to be put in the record. I think it is a rather revealing report.

The CHAIRMAN. Without objection, the insertion will be made.

(The list referred to follows:)

*Estimates of increase in personal income in the midsixties attributable to the tax bill*

[In millions of dollars]

State:	Distribution of personal income increase	State—Continued	Distribution of personal income increase
Total.....	30, 000	Missouri.....	690
Alabama.....	830	Montana.....	90
Alaska.....	30	Nebraska.....	210
Arizona.....	240	Nevada.....	90
Arkansas.....	180	New Hampshire.....	90
California.....	3, 510	New Jersey.....	1, 290
Colorado.....	300	New Mexico.....	120
Connecticut.....	570	New York.....	3, 360
Delaware.....	120	North Carolina.....	540
District of Columbia.....	150	North Dakota.....	90
Florida.....	840	Ohio.....	1, 650
Georgia.....	450	Oklahoma.....	300
Hawaii.....	120	Oregon.....	270
Idaho.....	90	Pennsylvania.....	1, 830
Illinois.....	2, 040	Rhode Island.....	150
Indiana.....	780	South Carolina.....	240
Iowa.....	390	South Dakota.....	90
Kansas.....	330	Tennessee.....	390
Kentucky.....	360	Texas.....	1, 410
Louisiana.....	390	Utah.....	120
Maine.....	120	Vermont.....	60
Maryland.....	630	Virginia.....	570
Massachusetts.....	990	Washington.....	510
Michigan.....	1, 320	West Virginia.....	210
Minnesota.....	540	Wisconsin.....	630
Mississippi.....	180	Wyoming.....	60

NOTE.—It is assumed that the effect of the \$11,000,000,000 tax reduction bill approved by the House of Representatives would be comparable to the \$40,000,000,000 increase in gross national product estimated last March by the staff of the Joint Economic Committee of Congress as the effect of a \$10,000,000,000 tax reduction. On the basis of historical relationships, such an increase in GNP would involve an increase in personal income of approximately \$30,000,000,000. This personal income increase was distributed among the States on the basis of unofficial population projections for each State for 1965, weighted by per capita personal income by States as estimated by the Department of Commerce for 1962 (the latest figures available).

Senator GORE. It shows the extent to which even the Treasury Department has gone in trying to sell this bill.

Secretary DILLON. Oh, no. This was made at the request of the Joint Economic Committee of the Congress. This was a study originally made by the Congress.

Senator GORE. I appreciate your response.

Mr. Secretary, is it correct to me to assume that there are three major ways in which the economy could be stimulated, either used singly or in interaction. These are tax reduction, public expenditure, and credit and monetary policy.

Secretary DILLON. In general one or another works better at one or another time. I think that under present circumstances it is undoubtedly true, and I think it has generally been true in the past, the recent past, that either expenditure policies or tax policy, fiscal policy has proved to be a more powerful weapon than credit policy. I think credit should be available, fully available, but we have the example of the 1930's when you had interest rates very low, and if there is not demand for the products, people just do not want to borrow the money, so you have to stimulate the economy so that it gets moving.

Senator GORE. I was only asking generally here.

Secretary DILLON. Yes.

Senator GORE. That is for the sake of our discussion, we might consider that these are the three major ways in which the economy could be stimulated.

Secretary DILLON. That is correct.

Senator GORE. Now in examining which of those or what combination of the three would be most effective, we have to determine, I think, the character of the stimulation which our economy needs.

Secretary DILLON. That is right.

Senator GORE. You agree with that?

Secretary DILLON. Yes.

Senator GORE. You indicated, a moment ago, that a great need, perhaps the major need, is for a stimulation of demand. Did I correctly understand that?

Secretary DILLON. I think that is right. I think that is highly important, if we are going to increase our economic activity—but it is not the only need. We have to increase incentives to invest. But without stronger demand, those incentives won't work at all.

Senator GORE. Mr. Secretary, I am not in any way trying to ask any tricky questions.

Secretary DILLON. No. I know that.

Senator GORE. These are straightforward.

Secretary DILLON. I agree.

Senator GORE. Then, if the greatest single need is to stimulate demand, I think we must examine, if we are going to intelligently determine the advisability of what course of action to pursue, which of these three major methods of stimulating the economy would most effectively stimulate demand.

Now I have cited to you an example in Tennessee. Maybe we have gotten more than our share of area redevelopment and APW funds. If so, I must express my gratitude to the administration, of which you are a part. We have needed it because we are part of this Appalachian area, where there was a great need for economic stimulation.

Now this illustrates, it seems to me, that by the right sort of public expenditure you can be specific, you can direct your remedy to the area, to the people, to the industry, to the segment of our economy that needs stimulation. Tax reduction is a scatter-gun technique, far more expensive, much less effective, in my view.

Now if I may just buttress my view, let me give you the amount expended for the APW and ARA programs in Tennessee. The total Federal grant funds for all of these projects is only about \$20 million. You see, this illustrates, in a small and in an isolated way, why I say that if we are going to try to solve the problem of unemployment, and stimulate demand, we can do it more effectively, far more cheaply, and then have something to show for our money, by helping to build needed community facilities than by giving tax relief, the largest benefits of which would go to those who need help least.

Now, lest I go too far without affording you the courtesy of commenting, I certainly yield.

Secretary DILON. Thank you, Senator. I would disagree on general results that we receive from APW nationally. I would not disagree at all on the importance of area redevelopment and such things as accelerated public works in meeting difficult situations such as you outlined in Tennessee, and I see no inconsistency in a broad program of tax reduction and in specific programs that are aimed at specific areas, such as the Appalachian area where a broad stimulation of demand will not be enough, and where special efforts are required.

On the national scale, which is what we have to look at, which is what we are looking at in this bill, we find that we have an average unemployment rate of 5.7 percent so far this year. This September, it was 5.6, which is the same as it was in September a year ago.

We have had APW, with all the good it has done in certain localities, in effect for a year, and it hasn't been able to make a dent at all nationally in the percentage of unemployed.

I think that I would go along with the philosophy I just mentioned earlier, but I think it is worth just reading two or three sentences from this statement of policy by the American Federation of Labor-CIO Executive Council on major legislative proposals, which met here in Washington on the 8th of October. They said:

The tax bill passed by the House will, if enacted, go far to provide jobs for those who seek them. Much of the tax reduction in the bill would go to low- and moderate-income groups. These families would spend their tax savings promptly on consumer goods and services. This spending in turn will provide more jobs for those who make goods and provide new services, and the new jobholders will, in turn, provide more jobs through their own increased consumption. The result will be to put the Nation back on the road to economic health.

Now I would say that we fundamentally agree with that, but while we cannot go to the public works public spending route to achieve that whole job—and going on this tax course makes it clear that we should not do that—that does not mean that every program aimed at specific areas has to be eliminated. It just means that for this very big job we cannot do it.

It would mean, I would say, if you were trying to get the same stimulation by public works throughout the country, you would not

have a \$900 or \$850 million accelerated public works program. You would have to have one that is 10 or 20 times as big.

On these very large ones, they have not proved as effective. They have had to take big projects that did not have the same labor potential.

One of the advantages of accelerated public works was that it is geared into the localities, as you know, and had local help, and did put more people to work and is putting more people to work per Government dollar than previous public works efforts have done. So I would say that is the only comment I have to make.

I think you have to have a proper mix here. We have felt that some major stimulus is needed, and that the best major stimulus is tax reduction.

Senator GORE. You have said many things, Mr. Secretary, to which I will return in a moment.

You said earlier that the major problem was stimulating demand. You referred in a statement you read here to the amount of tax benefits in the bill to various groups. You referred earlier in a general philosophical way to the effect of this bill.

I telephoned one of the principal Democratic leaders of the House of Representatives this morning, expressing my great concern that the area redevelopment bill, which we lost by only three votes in the House, be called up and be voted upon again. I also expressed my hope that the accelerated public works program could be extended. I will not identify the Democratic leader, but I want to tell you what he said to me this morning.

He said that the process of passing the tax bill over in the House had created a political atmosphere which made it impossible to pass the ARA or APW bill this year. Therefore, consideration of both would be postponed until next year, to see if the climate changed any. So you see, we don't operate in a vacuum here.

I expect to show, Mr. Secretary, I am going to try to show, that the total of your economic, monetary, and tax policies is not stimulative and expansive but restrictive and repressive.

When you take these three elements which you and I agree are the major ways in which the economy could be stimulated, and consider that they are also the three ways in which the economy can be contracted, and bear in mind that you said to the bankers in a speech just a few days ago that the passage of this bill would result in higher interest rates, and the fact that the political climate created here makes it likely that appropriations will be reduced four or five times the amount of the tax reduction in fiscal year 1964, I think I have come to the conclusion that your total program is not stimulative but repressive.

I will give you an opportunity to comment on that in a minute, but when you referred to the amount of increased income for people, I was reminded that I had asked Mr. Stam and his staff to prepare a table. Would you mind giving the Secretary a copy? Would you mind distributing this to the press table and to the members of the committee.

(The table referred to follows:)

TABLE 1.—Individual income tax liability: Under present law tax rates, under H.R. 8363 tax rates, and under uniform percentage increase in taxable income after present law tax: selected levels of taxable income, 1965, single person

Taxable income  (1)	Tax		Taxable income after tax		Reduction in tax or increase in taxable income after tax					
	Present law	H. R. 8363	Present law	H. R. 8363	Under H. R. 8363			Under uniform percentage increase in taxable income after tax (5.95 percent)		
					Amount	As percent of present law tax	As percent of taxable income after present law tax	Amount	As percent of present law tax	
										(6)
\$500	\$100	\$70	\$400	\$430	\$20	30.0	7.5	\$24	24.0	
\$1,000	200	145	800	855	55	27.5	6.9	45	24.0	
\$1,500	300	225	1,200	1,275	75	25.0	6.3	71	23.7	
\$2,000	400	310	1,600	1,690	90	22.5	5.6	95	23.8	
\$4,000	840	690	3,160	3,310	150	17.9	4.7	188	22.4	
\$6,000	1,360	1,130	4,640	4,870	230	16.9	5.0	276	20.3	
\$8,000	1,980	1,630	6,040	6,370	330	16.8	5.5	369	18.3	
\$10,000	2,640	2,190	7,300	7,810	450	17.0	6.1	488	16.6	
\$12,000	3,400	2,830	8,600	9,170	570	16.8	6.6	512	15.1	
\$14,000	4,260	3,550	9,740	10,450	710	16.7	7.3	580	13.6	
\$16,000	5,200	4,380	10,800	11,670	870	16.7	8.1	643	12.4	
\$18,000	6,200	5,170	11,800	12,830	1,030	16.6	8.7	702	11.3	
\$20,000	7,260	6,070	12,740	13,930	1,190	16.4	9.3	758	10.4	
\$22,000	8,380	7,030	13,620	14,970	1,350	16.1	9.9	810	9.7	
\$24,000	9,540	8,070	14,480	15,970	1,510	15.9	11.2	908	8.6	
\$26,000	10,740	9,070	15,260	16,970	1,670	15.9	12.8	1,044	7.2	
\$28,000	14,460	12,210	17,540	19,790	2,250	15.6	15.6	1,169	6.4	
\$30,000	18,360	15,310	19,640	22,490	2,850	15.5	14.5	1,279	5.7	
\$44,000	22,540	19,990	21,500	25,010	3,510	15.8	18.2	1,879	5.1	
\$50,000	28,820	22,530	25,180	27,410	4,230	15.3	21.5	1,828	4.5	
\$60,000	34,320	28,790	28,680	31,210	5,530	16.1	24.9	1,659	3.9	
\$70,000	42,120	35,190	27,880	34,810	6,930	16.5	28.3	1,772	3.5	
\$80,000	50,220	41,790	29,780	38,210	8,430	16.8	32.0	1,867	3.2	
\$90,000	58,620	48,590	31,380	41,410	10,030	17.1	36.2	1,944	2.9	
\$100,000	67,320	55,490	32,680	44,510	11,830	17.5	41.9	2,072	2.0	
\$150,000	111,820	90,490	38,180	50,510	21,330	19.1	72.6	2,569	1.6	
\$200,000	156,820	125,490	43,180	74,510	31,330	20.0	100.3	3,105	1.3	
\$300,000	247,820	195,490	52,180	104,510	52,330	21.1	119.9	3,640	1.1	
\$400,000	338,820	265,490	61,180	134,510	73,330	21.6	145.7	4,711	.9	
\$600,000	520,820	405,490	79,180	194,510	115,330	22.1	144.7	6,188	.9	
\$800,000	696,000	545,490	104,000	254,510	150,510	21.6	141.9	7,735	.9	
\$1,000,000	870,000	685,490	130,000	314,510	184,510	21.2				

Source: Staff of the Joint Committee on Internal Revenue Taxation, Oct. 4, 1963.

TABLE 2.—Individual income tax liability under present law tax rates, under H.R. 8363 tax rates, and under uniform percentage increase in taxable income after present law tax; selected levels of taxable income; 1965; married couple—joint return

Taxable income  (1)	Tax		Taxable income after tax		Reduction in tax or increase in taxable income after tax				
	Present law  (2)	H.R. 8363  (3)	Present law  (4)	H.R. 8363  (5)	Under H.R. 8363			Under uniform percentage increase in taxable income after tax (5.95 percent)	
					Amount  (6)	As percent of present law tax  (7)	As percent of taxable income after present law tax  (8)	Amount  (9)	As percent of present law tax  (10)
\$1,000									
\$2,000	\$200	\$140	\$800	\$860	\$60	30.0	7.5	\$48	24.0
\$3,000	400	290	1,600	1,710	110	27.5	6.9	95	23.8
\$4,000	600	450	2,400	2,550	150	25.0	6.3	143	23.8
\$8,000	800	620	3,200	3,380	180	22.5	5.6	190	23.8
\$12,000	1,680	1,380	6,320	6,620	300	17.9	4.7	376	22.4
\$16,000	2,720	2,260	9,280	9,740	460	16.9	5.0	552	20.3
\$20,000	3,920	3,260	12,080	12,740	660	16.8	5.5	719	18.3
\$24,000	5,280	4,380	14,720	15,620	900	17.0	6.1	876	16.6
\$28,000	6,860	5,660	17,200	18,340	1,140	16.8	6.6	1,023	15.0
\$32,000	8,520	7,100	19,480	20,900	1,420	16.7	7.3	1,159	13.6
\$36,000	10,400	8,660	21,600	23,340	1,740	16.7	8.1	1,285	12.4
\$40,000	12,400	10,340	23,600	25,660	2,060	16.6	8.7	1,404	11.3
\$44,000	14,520	12,140	25,480	27,860	2,380	16.4	9.3	1,516	10.4
\$52,000	16,760	14,060	27,240	29,940	2,700	16.1	9.9	1,621	9.7
\$64,000	21,480	18,060	30,520	33,940	3,420	15.9	11.2	1,816	8.5
\$76,000	28,920	24,420	35,080	39,580	4,500	15.6	12.8	2,087	7.2
\$88,000	36,720	31,020	39,280	44,880	5,700	15.5	14.5	2,337	6.4
\$100,000	45,000	37,880	43,000	50,020	7,020	15.6	16.3	2,559	5.7
\$120,000	53,640	45,180	46,380	54,820	8,460	15.8	18.2	2,758	5.1
\$140,000	68,640	57,580	51,360	62,420	11,060	16.1	21.5	3,056	4.5
\$160,000	84,240	70,380	55,760	69,620	13,860	16.5	24.9	3,318	3.9
\$180,000	100,440	83,580	59,560	76,420	16,860	16.8	28.3	3,544	3.5
\$200,000	117,240	97,180	62,760	82,820	20,060	17.1	32.0	3,734	3.2
\$300,000	134,640	110,980	65,360	89,020	23,660	17.6	36.2	3,889	2.9
\$400,000	223,640	180,980	76,360	119,020	42,660	19.1	55.9	4,543	2.0
\$600,000	313,640	250,980	86,360	149,020	62,660	20.0	72.5	5,138	1.6
\$800,000	405,640	390,980	104,360	209,020	104,660	21.1	100.3	6,209	1.3
\$1,000,000	677,640	530,980	122,360	269,020	146,660	21.6	119.9	7,280	1.1
	859,640	670,980	140,360	329,020	188,660	21.9	134.4	8,351	1.0

Source: Staff of the Joint Committee on Internal Revenue Taxation, Oct. 4, 1963.

Senator GORE. I have been trying to direct attention, Mr. Secretary, to the thing which is uppermost in the minds of most taxpayers, and that is the aftertax income. Now the workingman calls it take-home pay. The average lawyer will call it aftertax income. The real tax technician will call it taxable income after tax.

Now Mr. Stam, would you or someone on your staff please identify this table. I have particular reference to column 1, column 6, and column 8. That will give the taxable income of the taxpayer, the amount of increase in income after taxes, in dollars, and the percentage of increase of aftertax income.

Mr. STAM. Senator, Mr. Symons, who worked to prepare this table will be glad to explain it.

Senator GORE. Mr. Symons, will you explain it, please.

Mr. SYMONS. At the request of Senator Gore, this table was prepared, which shows the taxable income of the taxpayer, in this case table 1 is a single person taxpayer, and indicates the amount of tax reduction or increase in taxable income after tax under H.R. 8363, first in amount and then as a percentage of taxable income after tax.

Senator GORE. Will you take an exact figure. Take the taxpayer with \$6,000 taxable income and give us the amount in dollars by which his aftertax income will be increased.

Mr. SYMONS. It should be remembered that this table reflects only the tax rate changes because it was developed at the time when the staff was presenting to the committee, during the briefing sessions, the analysis of the tax rate changes under the bill as compared with present law. It was based on taxable income, because that was the concept which was requested.

The \$6,000 taxable income would show a tax reduction under the rates of the bill, the other provisions as to rates of \$230 for a percentage of tax reduction, or the percentage of taxable income after present law tax, 5 percent.

Senator GORE. Percentage of increase, isn't it correct to say?

Mr. SYMONS. The tax reduction which would increase the taxable income after present law tax by 5 percent.

Senator GORE. I have been citing these figures, and some people have found them a bit incredulous, so I asked that the technical staff prepare this table, Mr. Chairman, so that there could be no question about its accuracy.

Now let's go up to the \$12,000 income bracket.

Mr. SYMONS. A single individual with \$12,000 of taxable income would have a tax reduction as a result of the rate changes in H.R. 8363 of \$507, which when related to taxable income after tax, would increase that taxable income in the amount of tax by 6.6 percent.

Senator GORE. Now, what about \$50,000, at which most of the Treasury statistics I have seen stop.

Mr. SYMONS. At \$50,000 of taxable income, the single person under the tax rates of H.R. 8363 would have a tax reduction of \$4,230, and translated into the percentage increase in taxable income after tax would show such a percentage at 18.2 percent.

Senator GORE. Now take the \$100,000, \$200,000, and \$300,000 and then we will quit.

Mr. SYMONS. The \$100,000 taxable income of a single individual would enjoy a tax reduction under the tax rate of the bill of \$11,830,



which is a 17.6-percent tax cut, but a 36.2-percent increase in taxable income after tax.

The \$200,000 taxable income recipient would have a \$31,330 reduction in tax, which would represent an increase in taxable income after tax of 72.6 percent.

The \$300,000 taxable income would reflect under the tax rates of the bill a reduction of \$52,330 in tax for a 100.3-percent increase in taxable income after tax.

Senator GORE. Thank you. Mr. Secretary, would you like to question the staff in any way?

Secretary DILLON. No, no; I have no questions. I would like to comment if I may on a number of things that have been said.

Senator GORE. Could I make one brief comment first?

Secretary DILLON. Yes, sir.

Senator GORE. This illustrates why I have said, Mr. Secretary, that this bill is a major attack upon the progressive character of our income tax law.

The late Cordell Hull, author of the constitutional amendment making an income tax law possible, was an eloquent and effective advocate of taxation according to ability to pay.

Now I just simply do not think it is fair to give a 5-percent increase in aftertax income to the taxpayer with \$6,000 and a 141-percent increase, more than double, in aftertax income, to the person with \$1 million taxable income. I yield for whatever observations and comment or questions you may have.

Secretary DILLON. I have a number of comments. First, before we get to the table, I would just like to comment on two items you mentioned regarding my talk to the bankers. One was that enactment of this law, this tax reduction, would be likely to lead to higher interest rates.

Senator GORE. I have got a note here. I wanted to take those things up after we finished. Do you prefer to comment now?

Secretary DILLON. You quoted me, and I don't agree with the quote.

Senator GORE. Fine. Someone might leave and not hear your comment later. You are correct.

Secretary DILLON. I will be very quick on that. I made it very clear that this would only be as a result of the stimulation of the economy, and the fact that the economy would be moving toward full employment, and because of that, there would be greater demand for money, and it might well be that because of that greater prosperity, the normal supply and demand in money would lead to somewhat increased interest rates.

It is not meant to be an artificial action, a credit policy just because this bill is passed trying to increase interest rates. I just wanted to make that clear.

Senator GORE. Yes; you referred to it correctly. Nevertheless you do say that higher, long-term interest rates is an expected consequence of this bill, and to the extent that that occurs, it will be counterstimulative. I am not sure that is good English, but it would counter at least a part of whatever effect a tax reduction might have. I want to come to that later.

Secretary DILLON. Yes; we can come to that later. The other comment was I also said that there would be reductions in expenditures that would be four or five—

Senator GORE. I did not say you said that. This was my own estimate.

Secretary DILLON. Oh, four or five times the tax reduction—I am sorry, you did not say I said this. But your own estimate I think is erroneous then that appropriations will be reduced by four or five times the amount of the tax reduction in 1964, because tax reduction in calendar 1964 is \$7 billion. I don't think that there are going to be any reductions that would be that much.

Senator GORE. I think I will have to examine that figure.

Secretary DILLON. Maybe you were talking about fiscal 1964 figures, the first 6 months.

Senator GORE. Yes.

Secretary DILLON. The tax reduction in this bill is \$7 billion for calendar 1964.

Senator GORE. All right; we will come to that a little bit later.

Secretary DILLON. Yes. Then coming to this table, my chief comment on this table—I have a number of comments—is that as Mr. Symons has pointed out, it deals only with the rate reduction and only with taxable income.

Therefore, it takes no account of the many and various deductions from adjusted gross income, some of which will be reduced as the result of actions in this bill, and which are a vital part of an individual's income.

Looking only at taxable income and eliminating the personal deductions that are made, eliminates and throws out of kilter a great deal of what is the actual situation for any one individual. I would like to make one other comment.

Senator GORE. Could I point out something just in that respect?

Secretary DILLON. Yes.

Senator GORE. There are two tables there. The one on top deals with the single taxpayer. The second one—

Secretary DILLON. The married.

Senator GORE. The man and wife, filing a joint return. This takes into consideration, as I understand it, the personal exemption for each taxpayer and dependent.

Mr. SYMONS. The taxable income represents after.

Senator GORE. After this has been deducted from gross.

Mr. SYMONS. Yes. This particular table refers to just a couple, no dependents.

Secretary DILLON. None of these itemized deductions are in it. When we get to the very high levels, we have made a study, a rather quick study, but we don't think there is any individual in the country or any case that is comparable to this million dollar figure of taxable income that does not have any dividend income, for instance, because you see, we are not talking about the structural reforms here.

The figures in the table reflect only a tax on earnings, salary, and I don't think anyone is paid that much. It does not reflect what would be the situation of tax on dividends, which would mean a 4-percent credit which would come off this total.

Senator GORE. Will you comment on the level of income at which many of the high officials of the large corporations have salaries from the \$200,000 to \$400,000 bracket? That is normal income, is it not?

Secretary DILLON. Yes. We found one case that would come somewhat close to your calculations here. It was an individual who appar-

ently had wages and salary of some \$480,000, some dividends, and some interest, but no capital gains—though such gains are the usual thing with higher income people. His actual percentage increase in after-tax taxable income came to—it was a very high percentage—came to some 84 percent, but that compares with somewhere between 119 and 145 on this table.

He probably was married, so it would be better to take the other table. In that case, it came to something roughly comparable to your figure. But we found only one individual, but only up to that level. I would also like to point out—

Senator GORE. Before you leave that one man, if you don't mind—  
Secretary DILLON. Yes.

Senator GORE. I think it is interesting that you have come up with one taxpayer whose after-tax income, whose take-home pay would be increased by 84 percent as a result of this bill.

Secretary DILLON. We don't think so. We think that the proper way is to take not taxable income but to include the dividend credit and include the fact that it is being repealed and include all the other things which would be the result of this bill, which would be his percentage increase in after tax adjusted gross income including capital gains, and that would be 56 percent, which is still high but it is not 85.

Senator GORE. I did not provide the example, you did.

Secretary DILLON. I know, but I used your method.

Senator GORE. Whether it is 56 or 84—

Secretary DILLON. Fifty-six, I think that is right.

Senator GORE. You see, what you are doing here is applying the largest percentages to the largest amounts, and the smallest percentages to the smallest amounts. This, it seems to me, is a major attack, I repeat, upon the progressive character of our income tax. It is a reversal of the graduated system by which people pay according to ability to pay.

Secretary DILLON. I would disagree completely with that, Senator. I am just coming to that. I am glad you mentioned it.

Senator GORE. Well, Mr. Henry Ford disagrees, too.

Secretary DILLON. Yes. I would disagree, and I would like to be able to say why.

Senator GORE. Excuse me, I did not mean to interrupt.

Secretary DILLON. Your column 7 here, the column 7 on this table, showing the percent decreases of percent of present tax shows that that figure is roughly a level figure, with some special benefits at the bottom and some special benefits which we have mentioned at the very highest levels. We felt that tax rates at the very highest levels were too high, and simply meant that people instead of spending their energies working to help the economy, spent their energies trying to avoid paying taxes, in which they are very successful, because as the figures that were read yesterday show, most of these high income tax people pay tax at less than 50 percent on the average.

It is inherent in the fact that if you are going to reduce these very high levels of tax, that there will be a very much larger increase in after-tax income for those who are paying the high taxes.

Take a simple example. Our present lowest rate is 20 percent, so therefore after-tax income of that individual is 80 percent. We take 1 percentage point off that, his tax, which is 5 percent of his tax, and his after-tax income is increased one-eightieth, which is 1.25 percent.

We take 1 point off the tax of a man who is paying taxes at the rate of 90 percent, this is only 1.1 percent of his tax but now he has a 10-percent increase in his after-tax income because he keeps 11 percent instead of 10 percent. So if we are not going to maintain the present rates exactly as they are, or with no noticeable change at all, it is inevitable that as we reduce those extremely high rates which were put on in wartime, that they would lead to a greater percentage increase in after-tax income.

We have tried to make the percentage decrease in taxes even all the way along the line with a special extra benefit for those with incomes of \$1,500 or less taxable income, which are probably half our taxpayers or a little more, and also a slightly greater percentage increase for those with incomes that are very high, in order to get down to a top figure on which we feel there is a general consensus. We first recommended 65 percent, it is now 70 percent, which I think is perfectly adequate for this purpose. That means that the Government takes two-thirds of whatever this man earns.

We would think that if you get above that, I think the record shows it, individual incentive is misdirected. It is directed to ways and means not of trying to do a better job but rather to insure a better pension or a tax-free pension or some option possibly, or anything of that nature to get around paying these taxes.

This has been accepted. There is no opposition to these tax cuts from the general economic profession. There is no opposition to it from the American Federation of Labor. They see no reason why the top rates should not be reduced to a 70-percent level.

They may have some comments on details of this bill at the bottom level, but they have no objection to that, and even your friend and my friend, the Senator from Illinois, said yesterday he saw no reason why these very high rates should not be reduced, provided you close an adequate number of loopholes, and we are trying to do that.

We have not been as successful as we would like to be in closing all of the loopholes. You have been a staunch supporter in that effort, and we welcome your assistance. But we have not been able to get a majority either of this body—I am speaking of the Senate as a whole—for many of these things, or of the House, despite what efforts we have made.

But I think the question, when you are reducing the impact of taxes, is to look at what the taxes are. If you reduce the taxes at a level rate across the board, which is what we have recommended, which the President has consistently recommended, and in every statement he has made on this subject he has talked about across the board, top to bottom cuts in taxes, there will be this result.

Those who are now keeping a very small percentage of their income will naturally have that increased more than those for whom taxes are really not a very heavy part of their economic situation. The reverse of that is, as the chairman pointed out, the average tax saving was only a few dollars a year to some people in the low-income brackets, because they don't pay many taxes. We cut them 40 percent, but still it is only \$49 according to the chairman's computation.

Senator GORE. Mr. Secretary, you referred to comments yesterday of the senior Senator from Illinois. I don't think I could improve on his remarks yesterday describing the alacrity with which the Treasury

had abandoned tax reform, and you are not now in fact supporting the very recommendations which you made earlier this year.

Secretary DILLON. We are not renewing them.

Senator GORE. I beg your pardon.

Secretary DILLON. We are not renewing them.

Senator GORE. You are not renewing them?

Secretary DILLON. We are not renewing the recommendations.

Senator GORE. Now just what do you mean by that?

Secretary DILLON. We are not asking the committee to make these changes. If the committee wishes to consider them and wishes to make some of them, we would feel very happy, because the bill would be more in line with what we think is fair.

But in view of what we consider the overriding economic necessity of getting a bill, and in view of our efforts—which do not indicate any alacrity in abandoning these reforms—we are not asking for these changes. The reason that the House of Representatives took some 8 months on this bill was largely because of the effort we put in to obtain these reforms.

There were many—in what some might call the liberal camp—who felt that, in order to get the tax cut promptly, we should not bother with these reforms last spring. Here is a place again where our emphasis was somewhat different from that of the Chairman of the Council of Economic Advisers, because he was afraid that we were making too great an effort for tax reform at this particular time.

We said no. We thought they are important and we were going to try our best. We tried for 8 months. If we had not tried, we would not have gotten what we have, so I think we have made a real effort.

Senator GORE. You said a few moments ago that most of the really high income people were paying taxes at a rate less than 50 percent.

Senator Long made an eloquent speech in the Senate yesterday, in which he said, among other things, that there were taxpayers with annual income of \$1 million who paid little or no taxes. The lesson I get from what you have said, and from what Senator Long has said, what Senator Douglas said yesterday, is that tax reform is more vital, is more direfully needed than tax reduction. There are more efficient, more economical ways to stimulate our economy than tax reduction.

I would like to go to the general questions, unless you wish to make some comment on that.

Secretary DILLON. No.

Senator GORE. I think you have already expressed your views, and I have expressed mine.

Secretary DILLON. It is just an ideological difference as to how we can stimulate the economy.

Senator GORE. We will agree to disagree on that point.

I do want to go to this basic question of just how tax reduction is going to stimulate demand. Now where is the pent-up demand in our economy? Is the demand for more hotels or more school buildings?

Secretary DILLON. I think if we stimulate consumer demand, it will be in all sorts of goods and services with individual consumers, and there will be a major increase there.

As I say, the Joint Economic Committee made their best estimate and came up with the fact that a \$10 billion cut would increase our

gross national product, which means what we would produce, by \$40 billion. And something of that sort we think would help.

That does not mean that there are not great needs in various specific areas. As I said in talking to Senator Ribicoff when he was questioning me yesterday, personally I think one of the greatest needs in the country is improved educational facilities, and I strongly support the various educational proposals that have been made.

Senator GORE. That is a demand in the public sector, isn't it?

Secretary DILLON. That particular demand can only be met in the public sector either locally or federally, and I think there is need for some Federal help there.

Senator GORE. So your answer is that as between hotels and schools, there is a greater need for schools.

Secretary DILLON. At the moment, I think that the building boom in hotels and motels is probably pretty well satisfied as to demand there.

Senator GORE. Would you say that we need more capacity to produce automobiles, or an improved rapid transit system in our metropolitan areas?

Secretary DILLON. I think that we need both probably. We certainly need a better rapid transit system. When I say both, I am not talking about the automobile industry. I don't pretend to be an expert in that particular industry.

What I am talking about is the capacity to produce goods and services that the country could consume. I certainly think that we do need to operate at capacity, which means that instead of having 5½ percent unemployment, we will reduce the unemployed figure by several million, and get down to 4 percent unemployment. That means that we will have to produce much more.

I don't think that we can achieve 4 percent unemployment by a few, even though they are expensive, major public works programs, such as the mass transit program in New York, which is vitally needed. I come from that area, and I know how vitally needed it is.

Senator GORE. I have a whole sheet here of either/or, which is needed. I will not belabor my point. My view is that the real pent-up demand in our economy is in the public sector.

Now I am not sure that our need is for increased productive capacity as much as it is for increased consumer demand. There seems to be ample productive capacity for automobiles, refrigerators, radios, television, furniture. I really don't know of an instance in which there is a shortage of productive capacity.

Secretary DILLON. I think, at the moment, that is correct. That is one of the reasons there is no inflationary pressure from this bill, because, in general, we are operating below capacity, although I saw, for instance, the other day, a statement saying that the tire industry, or one of the great companies in it, was operating at 99 percent of capacity. So if we go slightly further in producing cars, I could easily see where they would need increased capacity, and there may be other instances of that nature.

But certainly the need is twofold as we see it. It is to increase consumer demand and also to increase incentives, both to work and to invest. And by increasing incentives to invest, we will increase demand for capital goods which will help to provide jobs, and an equally important part of demand is consumer demand.

Senator GORE. Mr. Secretary, I have trespassed beyond my rights, as you can recognize and agree, I am sure. You and I could discuss this for a week, and I am sure we would still differ.

Secretary DILLON. I would like to let Mr. Heller answer a lot of these questions. He is probably more capable to answer than I.

Senator GORE. No. I have a hard time matching wits with you. I think I have made my principal points. There are others I would like to make, and, if I may, I will submit some questions in writing, but I certainly don't wish to go beyond the noon hour with you.

(The questions referred to appear at the end of Senator Gore's interrogation.)

If I may briefly conclude, I would like to say instead of using credit and monetary policy in a stimulative way, you and Mr. Martin and others have advocated and put into practice a tight money, high interest rate, restrictive policy.

Instead of trying to bring about full employment, which is a national goal to which the Congress and the President have given assent, by providing jobs for American citizens who, in my opinion, are entitled to work at a decent wage, the field is reversed and now stimulation of the public side is condemned. I think it amounts to a repudiation of the record of Franklin D. Roosevelt, Harry Truman, and all of the Democratic platforms of the last 30 years, including the one in 1960.

I think this is a most unwise thing. I think it is bad for the country. I feel deeply that it violates the traditions of the Democratic Party to which I have been loyal for so long.

I would be willing to consider tax reduction in some respects. I don't think I could under any circumstances support so large a reduction in governmental revenue as \$11 billion. I guess that is a matter of judgment as to where the safe level is.

I have but one other point I wish to make, and then, so help me, I will quit. I have a feeling that if we are going to start repealing the wartime levies, if we are going to seek the solution to this problem through taxation, to the disregard of the other two principal ways, both of which would be more feasible, more effective, and more efficient, in my opinion, then I think we should provide that kind of tax reduction which will most stimulate demand, as well as provide the greatest social justice.

Now, I was a Member of Congress and voted for the wartime levies. The most onerous vote I cast was to reduce the personal exemption. The personal exemption for a taxpayer in 1940 was \$800; we reduced it to \$600.

Why did we do that? It was for two reasons: One, to raise some revenue for the war and, secondly, and equally important, to dampen consumer demand, in order that a greater war effort could be made.

Now when the cost of living is almost  $2\frac{1}{2}$  times what it was in 1940, the personal exemption is still at \$600. In 1940 the personal exemption for a married couple was \$2,000; it is now \$1,200.

Now if we want to use taxation alone as a major instrument of solving this problem of unemployment, of stimulating demand in our economy, it seems to me the only logical, reasonable step to take, and one which social justice would dictate, would be to raise the personal exemption from \$600 to as high as we think can be justified in reduction of governmental revenue.

I conclude by saying that I shall offer this as an amendment, as a substitute for the rate cuts in this bill, whenever it reaches the floor, and I shall make the hardest fight of which I am physically and mentally capable, because I think if we must depend upon taxation, and the administration seems hellbent upon it, then I think we ought to provide the kind of tax reduction that will provide social justice and more effectively do the job—period, finished for me. You may comment as you like.

Secretary DILLON. I would like to comment briefly on your characterization of our monetary policy, where again I find myself in disagreement with you. While, for balance-of-payments reasons to protect our gold stock and to protect the value of the dollar, we have followed a policy where we found it necessary to promote higher short-term interest rates to prevent the outflow of dollars which could easily go abroad and get those higher short-term rates, we have nevertheless maintained an adequate availability of credit and adequate low-interest rates in the longer term area. We have accomplished this in a way that many, in fact, when it was first started, I think the majority, in the financial community, thought impossible.

The result of that is that today, after 2½ years of recovery, contrary to the situation in previous recoveries, rates of interest on long-term corporate bonds are similar to what they were at the bottom of the recession.

The rates on municipal bonds are lower than they were at the bottom of the depression, and the rates on mortgage lending are a full one-half percent lower than they were at that time.

In fact, the problem that many savings and loan institutions are now facing is that they have more money than they know what to do with. They can't get people to borrow it, so they want to have the laws changed so they can go into other kinds of business and use their money elsewhere.

So I don't think that our monetary policy has, in fact, been restrictive at all, because the important rates for growth are the longer term rates, the rates that affect personal borrowing.

There has been no change in any of the bank rates. In fact, average bank lending rates, although there has been no change in the prime rates, the average bank lending rates have gone down.

As to the other question as to where to make the tax reduction, we have felt that there was a very real problem in the situation of the exemptions staying the same. We agree with you about that, and we have evolved and suggested—

Senator GORE. Did I understand—

Secretary DILLON. I said we agreed with you that something had to be done about that, and so therefore we evolved and suggested—

Senator GORE. But not much.

Secretary DILLON. And had put into the House bill, which was approved by the House, a minimum standard deduction which insures that the entire amount that goes there goes to those who are really at the bottom end and who are really suffering from lack of adequate income.

A very substantial raise in the general level of exemption would be very costly. I have heard the figure of an increase to as high as \$1,000, which would cost more than the entire program that we are recommend-



ing and would in effect put a great premium and create great inequities among the great mass of our working class people, because it would mean that those who, for one reason or another, were able to produce large enough families, would pay no tax at all, and those that had one or two children would pay a substantial tax, even though they were doing the same job, getting the same income, and having relatively the same expenses, because certainly the expense of one additional child is not as much at that level as a \$1,000 exemption.

It also would make no change in these rates, which we feel were confiscatory at the upper level, and it would do nothing to stimulate investment incentives, and we think that a mixed package that has the best possible allocation for all these various areas is the one that will be the most effective in stimulating the economy, and that is the fairest.

I think that it is rather remarkable—I don't think this has happened before—that a package was devised, was passed by the House which had the full support of both the labor leaders, the AFL and the CIO, and the business community, as well as the great mass of economists who have studied our problems of unemployment and growth throughout the country.

There is lots of room for difference of opinion, and no one can be sure he is right. However, while I have no feeling that everything I happen to believe is right, it may well not be, certainly I have drawn some comfort from a large consensus that seems to support this type of program.

Senator GORE. If you would permit me to violate my self-imposed injunction, I will be very brief. You referred to the surplus of investment capital on the part of certain institutions.

Secretary DILLON. I said the "savings and loan people."

Senator GORE. Yes. In fact, there is no shortage of investment capital in our economy. Corporations are in an extremely liquid position.

A manufacturer does not make an investment merely because he has the money. If there is a sufficient demand for his product that he thinks he can build a new wing to his factory and make a profit, if he does not have the money he is apt to go out and borrow it.

So we come back to this basic thing which you agree is very basic, stimulation of demand. The type of tax reduction I suggest, though I would not support it in the magnitude of \$11 billion, would have the maximum effect on stimulation of demand.

Now, the minimum standard deduction to which you refer, that is, in the House bill, is really but a lick and a promise at the problem. Total tax reduction which this provision provides, is only a little over \$300 million out of the \$11 billion bill. So I did want to make those comments.

Secretary DILLON. Yes, that is correct. It all goes practically to those who have less than \$5,000 of income.

I would agree with you, Senator, that the problem of cash flow in our corporations is not the big problem that we face today. It is the question of profitability which rests on a combination of demand for their product, just as you pointed out, and on the tax rates and the amount of profit they can make in filling that demand.

Therefore, I think some tax reduction there is important. This cash flow problem on which you and I, as well as the House, agree, led us to

believe that there is no hardship at all on the larger corporations in asking them to accelerate their tax payments. In effect, while their profitability is increased their cash flow is not increased.

Senator GORE. Mr. Secretary, I have a whole notebook full of questions here. I will not submit them all to you, but if I may submit a few questions of a more sophisticated nature, and if you would be willing to respond to them for the record, I would appreciate it, and I would ask unanimous consent to insert my questions and the Secretary's answers.

The CHAIRMAN. Without objection.

(The questions submitted by Senator Gore and replies furnished by Secretary Dillon follow:)

QUESTIONS SUBMITTED IN WRITING BY SENATOR GORE TO SECRETARY DILLON AND ANSWERS OF SECRETARY DILLON SUBSEQUENTLY PREPARED IN RESPONSE

Question 1. Is this bill designed to effect long-term tax reform, insofar as the rate structure is concerned, or is it primarily designed to counter a feared recession in 1964?

Answer. The bill is designed primarily to effect basic long-term tax reform. Generally this reform is designed to reduce tax rates about in proportion to the present rates, with special provisions for those in the lowest brackets, and to make other desirable structural changes in the tax system. Another effect of the bill is that it should serve to counter the recurrent pattern of recessions which has plagued our economy, increased unemployment, and led to substantial underutilization of resources.

Question 2. In your statement to the committee, you said that delay "would incur serious economic risks." Are these long- or short-term risks?

Answer. The possible risks involved in delay of action on the tax bill are both long- and short-term risks. If through delay in action on the tax bill a recession should develop in the period ahead, this would, in addition to its immediate effects, break the pattern of economic growth that we have had over the past 2½ years. The long-term beneficial effects of the tax bill would be considerably delayed if it was first necessary to restore the economy to a pattern of expansion. There would be also a permanent loss associated with the income and investment that would be lost through a possible recession in the period ahead, and the increase in public debt such a recession would cause.

Question 3. Taking into account the usual adjustments for this time of year, and the fact that the third quarter was unusually good, are there any real indications that a recession may occur before January 1, 1964?

Answer. I would say that there is no serious threat of a recession before January 1, 1964. Failure to enact the tax bill during this session would lead to uncertainty regarding its eventual fate. Any general impression that the bill might not be enacted would certainly reduce business confidence. Since it is not possible to predict how long the present economic expansion can continue on its own into 1964, it is highly important that the bill be enacted this year.

Question 4. Do you consider a deliberately created deficit an integral part of a program for stimulating the economy by means of tax reduction?

Answer. No I do not. However, it is necessary to reduce the tax brake on our private economy if we are to have any hope of reaching full employment. This necessarily involves a brief transitional increase in the deficit until the stimulative effects of the tax cut can have time to produce increased revenues. I would not call this process one of a "deliberately created deficit" since a deficit presently exists and without the corrective effect of a tax reduction there is every chance that the course of the economy would produce a much greater deficit than either exists today or is anticipated as a transitory deficit as we move to full employment under the tax reduction.

Question 5. On page 6 of your statement you speak of a "sustained increase" in demand. Do the beneficial effects of this tax cut flow forever? When a balanced budget is achieved in the future, will further cuts be necessary?

Answer. As I have said, we believe that with the tax cuts in the bill the economy will be able to achieve something like full employment with balanced budgets. Much the most difficult job is to reach full employment on a noninflation-

any basis. Once that has been accomplished, as we believe it can be with enactment of the tax bill, it should be easier to maintain full employment and balanced budgets. Since we will then be operating under a more appropriate tax system, the benefits of the tax cut will continue indefinitely. Such future changes in tax fiscal and monetary policy as may prove desirable from time to time should be much less drastic in their effects in either direction than the action that is presently required to reduce our unrealistic tax burden.

Question 6. Do you expect to see a substantial reduction in the national debt during your lifetime,

Answer. As I indicated the other day, I do not see any immediate prospect for substantial reduction in the national debt. The immediate goal of our program is to reach a point of a substantial budgetary balance so that increases in the national debt will no longer be necessary. With a stable debt, the growing wealth of our economy will make the burden of the debt easier for our citizens to sustain.

Question 7. How much of the tax cut do you feel will go toward increasing consumer demand, and how much toward increased investment?

Answer. This is a difficult question to answer in view of the fact that the part of the tax reduction which will increase consumer demand will in the regular flow of economic advance serve to produce increased investment. About 80 percent of the reductions provided under the bill goes to individuals and about 20 percent goes to corporations. As I indicated in my statement, when taken in conjunction with the 1962 action, these changes distribute the benefits of tax reduction between individuals and corporations in proportion to their respective shares in the income tax.

Question 8. What increase in the GNP in 1964 will be directly attributable to increased consumer spending brought about by this bill? In 1965?

Question 9. How much investment will be induced by this bill in 1964? In 1965.

Question 10. What would the GNP likely be in 1964 without a tax cut? With a tax cut?

Answer. As I have said, it is implicit in the Treasury estimates of the feedback effects of the tax bill that the GNP will be higher by \$12.5 billion in the calendar year 1964. Assuming a continuation of the present 3- to 3½-percent growth rate in 1964 without the tax bill, the GNP should be about \$600 billion, and adding the \$12 billion tax bill effect would bring it to about \$612 billion in today's prices. This difference, of course, would be much larger if a recession were to occur in 1964 without the tax bill.

So far as 1964 is concerned I believe that most of the increase in GNP will be from increased consumer spending and only a relatively small portion of the increase in GNP that would follow from the tax bill could be attributed to increased investment. This arises from the fact that changes in investment plans take a relatively long time to come into operation. The higher level of consumption expenditure will probably induce some inventory accumulation, however.

If we compare the expected development of GNP under the tax bill with average growth during 1964 without the tax bill, the difference in investment would be \$1 billion or more, principally because of the fact that the investment response is slower than the response of consumer demand. By 1965 this increase in investment demand should exceed \$3 billion. However, if one assumes that a recession would begin sometime in 1964 in the absence of the tax bill, then the passage of the tax bill would mean that the increased investment in 1964 and 1965 would be several billion dollars higher than these figures.

So far as 1965 is concerned I should further point out first that gross private domestic investment excluding residential construction and inventory accumulation comes to about 9 percent of the GNP. I would think that in 1965 the increase in this category of investment induced by the tax bill would be somewhat less than 9 percent of the increase in GNP induced by the tax bill. Here again the result is largely attributable to the fact that investment plans change more slowly than consumer spending plans. As to consumer spending in 1965 brought about by the tax bill, we would anticipate increases in the range of \$25 to \$30 billion.

Question 11. To what extent have our postwar recessions been characterized by lack of consumer purchasing power?

Answer. Postwar recessions have been characterized to some extent by a lack of consumer purchasing power in the sense that the decline in Government

expenditures in 1954 and the decline in investment expenditures in 1949, 1954, 1958, and 1961 meant lower purchasing power and consequently lower consumer demand. Furthermore, the excessive tax load of recent years has held down both consumer demand and business investment. I don't know that there is any way to say just how much of the lack of growth is attributable to low investment and how much attributable to lack of consumer purchasing power.

Question 12. The Consumer Advisory Council in its first report, submitted in October of this year, stated, "Since it is the low-income consumers who have the greatest unmet needs and who are most likely to spend [a higher percentage of] the additional money which a tax cut would permit them to retain, the major cuts should come in the taxes of the small taxpayer."

Does this bill carry out that recommendation?

Answer. Under the House bill about 80 percent of the tax reduction goes to consumers, and about 59 percent of the reduction in individual taxes goes to taxpayers whose adjusted gross income is less than \$10,000. Furthermore, the reductions in the area below \$10,000 are significantly higher as a percentage of present taxes than are the reductions for taxpayers whose income exceeds \$10,000.

Question 13. Has the ostensible lag in plant and equipment expenditures in recent years been caused by a lack of readily available investment capital?

Answer. I take it that this question in referring to "readily available investment capital" refers to the availability of cash funds to corporations to finance investment. In this sense there clearly is no overall lack of such funds at the present time although a few major industries such as steel and railroads have been held back in their investment plans by a lack of readily available cash. But, on an overall basis, I do not think that this has been the principal problem holding back investment during recent years. At the present time it is our view that the more important problems are those related to the prospective rate of profit on additional investment, and the problem arising from inadequate markets. Both of these problems are dealt with in the tax bill.

Question 14. What was the difference between corporate cash flows and plant and equipment expenditures in 1962? 1961?

Answer. In 1961 the cash flow of nonfinancial corporations from retained profits and depreciation reserves came to \$29.6 billion. In that year the plant and equipment expenditure of nonfinancial corporations was also \$29.6 billion. In 1962 this cash flow rose to \$34.9 billion and the plant and equipment expenditure rose to \$32 billion. In the latter year additions to inventory also rose by about \$2 billion. I might point out that both of these years represent a relatively depressed level of plant and equipment expenditure in view of the fact that ordinarily business firms would invest more in plant and equipment than is capable of being financed from their internal cash flow. That is, they would draw on the net savings of the rest of the economy. This did not happen in 1961 and 1962 unless one takes into account the additions to inventory in those 2 years. Corporations did have to draw on external funds to finance inventory additions.

Question 15. You relate (p. 3) plant and equipment expenditures to GNP. Are you satisfied with our statistics on this point? Can you refine these figures and relate plant and equipment expenditures in manufacturing to the value of goods manufactured; plant and equipment expenditures in the service area to that component of GNP attributable to services?

Answer. The data for this comparison are not readily available since in the published GNP series related to the production of goods, there is included the value added in the retailing and wholesaling of these goods. For many purposes retailing and wholesaling are considered to be services, although it is a service particularly attached to goods. In the available data for business expenditures for new plant and equipment classified by industry, the expenditures related to retailing and wholesaling are not separated from other service industries.

To put the data on a consistent basis, the following table uses an estimate of the GNP derived from manufacturing. This is not a published series but was constructed by adding to the national income arising from manufacturing, the estimate of depreciation attributable to manufacturing. (This yields GNP at factory prices; i.e., not including indirect taxes.) This estimate was combined with the SEC-Department of Commerce figure for business expenditure on new plant and equipment in manufacturing. The other ratio was constructed in a similar manner using an estimate of GNP from all business other than manufac-

turing. This "all other" component includes mining, transportation, other public utilities, trade, service, finance, communications, and construction.

*Ratio of expenditure on plant and equipment to GNP component*

	Manufacturing business	Nonmanufacturing business		Manufacturing business	Nonmanufacturing business
1962.....	10.3	8.0	1954.....	11.3	8.4
1961.....	10.4	7.8	1953.....	11.5	8.9
1960.....	11.0	8.2	1952.....	12.2	8.3
1959.....	9.3	8.3	1951.....	11.7	8.7
1958.....	10.1	8.2	1950.....	9.6	8.6
1957.....	13.1	9.3	1949.....	10.8	9.0
1956.....	12.7	9.4	1948.....	13.1	9.4
1955.....	10.2	8.6	1947.....	14.2	9.0

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Question 16. It has been stated repeatedly that the large amount of taxes collected in this country acts as a "brake" on the economy. How does the total tax take in the United States compare with total revenues collected in other leading industrial countries? As a percentage of GNP?

Answer. The following table shows the taxes as a percentage of GNP, for the year 1961, for the United States and selected European countries. Since social security systems figure very importantly in some European systems, the table shows the percentage including and excluding social security taxes. The table refers to all levels of government.

*Taxes as percentage of GNP, United States and selected European countries, 1961*

	Including social security contributions	Excluding social security contributions
France.....	35	23
Germany.....	35	25
Italy.....	28	20
United Kingdom.....	29	25
United States.....	28	24
United States with tax cut.....	26	22

The "brake" of our tax structure is not, however, solely due to its relationship to GNP. It is essential to consider other factors—such as the level of Government expenditures, the basic strength of investment demands apart from tax considerations, and the relationship between increases in income and taxes—in evaluating the tax structure. Thus, in the United States the impact of our present personal income tax structure at all levels increases sharply as the economy expands, and during periods of expansion our tax take grows much more rapidly than the economy. It is this tendency for a large part of any rise in incomes to be siphoned off in taxes that serves as a strong brake to progress. This braking effect will be reduced by enactment of the tax bill, because the proportion of taxes to GNP will be reduced at all levels of income, and the tendency for taxes to rise faster than GNP will be moderated, thus enabling restoration of full employment without implying a taxload that is simply too large relative to expansionary forces elsewhere in the economy.

It should be sharply emphasized, however, that simple comparisons between the fiscal structures of different countries do not tell us too much. For example, the European countries have extensive social welfare programs, by which they funnel through government channels many of the things we do through private means. This accounts for the high ratio of taxes, including social security, to GNP encountered in Germany, France, and Italy. Some countries employ extensive subsidy programs. There are countless other structural differences that should make one wary about generalizing about apparent differences in taxing and spending programs as between nations.

Question 17. In contrasting United States and European economic experience (p. 4), do you take into account—

(1) Direct government controls in Europe?

(2) The fact that European countries have been building from a near-zero base?

(3) Artificially induced capital flows to Europe (foreign aid, etc.)?

Do any major European countries follow what we call a free market system in the international flow of goods and capital?

Answer. In the early postwar years the rate of economic expansion in Europe was, of course, greatly affected by the fact that these countries were reconstructing their economies from a very low base and by the fact that they were receiving substantial amounts of assistance from North America. I think it must be acknowledged, however, that the substantial and steady rates of growth maintained by Western Europe in recent years has been achieved without "artificially induced" capital flows. Furthermore, the framework of direct governmental control has been greatly relaxed in all the Western European countries, although this process has gone further in some countries than in others. All the major Western European countries have completely eliminated governmental restrictions on transfers of their currency for transactions in goods and services, and several have removed controls over capital transactions as well. Germany, for instance, has no direct controls over the international flow of capital. The French Government has a fairly elaborate system of planning within the domestic economy, but the German Government prides itself on the maintenance of a free market system. Consequently, while European conditions have differed from our own in some important respects, these differences in recent years have not been of such a character as to indicate that the United States cannot also achieve sustained rapid growth.

Question 18. The very young consume little. Is it logical to assume that we will experience an increase in demand because of the arrival at maturity of the large baby crops of the middle 1940's?

Answer. The implication of this question is that there may be a marked upward shift in the proportion of income people spend on consumption.

The following table shows the composition of the age labor force, including projections through 1975. This table is designed to show two categories of the "very young and the aged." One category includes those below 14 years; the other, those 19 years and below.

The table shows that we already have, during the decade of 1950, experienced a marked shift in the population's age composition. Yet despite this shift, there has not occurred a sharp increase in the ratio of GNP that is consumed. It has remained around 65 percent of GNP, which has been the proportion since World War II. As the table further shows, the proportion of the population in very young and very old age groups will remain relatively stable over the next decade.

*Age composition of the U.S. population, 1950-75*

	1950	1960	1965	1970	1975
Population (millions).....	152.3	180.7	194.5	208.9	226.0
Under 14 years.....	38.8	53.4	56.1	58.1	62.8
14 to 19 years.....	12.9	16.1	20.5	22.9	24.5
65 and over.....	12.3	16.7	18.2	20.0	22.0
Percentage composition:					
Under 14 and over 65.....	33.6	38.8	38.2	37.4	37.5
19 and under and over 65.....	42.0	47.7	48.7	48.3	48.4

Source: U.S. Department of Labor, "Manpower Report of the President," March 1963, table 24, p. 86.

In addition, whatever modest increase in demand may result from the small changes indicated above is likely to be more than counterbalanced by more rapid growth in the labor force, which in the absence of the stimulus to be provided by the tax bill, would mean greater unemployment.

Question 19. If the deficits which are to be expected are financed out of true savings, will this negate much of the expansionary effect of the tax cut?

Answer. It is not possible several years in advance to forecast exactly how the deficit resulting from the tax cut will be financed. However, based on past experience we believe that it will be possible to do so without negating the ex-

pansionary effect of the tax cut and, on the other extreme, without bringing about inflationary consequences.

Question 2C. If the deficits are monetized, can this lead to inflation? Is there such a thing as monetary inflation? Do you recognize the validity of the formula  $P'T = MV + M'V'$ ?

Answer. I accept the proposition the equation implies, which is the notion that the quantity of money ( $M$  and  $M'$ ) in an economic system affects peoples behavior; and the rate at which they spend it ( $V$  and  $V'$ ) also exerts an influence on prices ( $P$ ) and the amount of economic activity. If the question about the equation's validity asks whether I believe there is a strict and proportionate line of causation between the quantity of money and the price level, which was the proposition its early proponents accepted, I do not believe that proposition is valid. An increase in the quantity of money can be offset by a decline in its velocity (or the rate at which people spend), or an increase in the price level, or an increase in output ( $T$ ), or some combination of all three. The relationships are complex.

More generally, the question treats the problem of inflation and its relationship to the tax bill. The attached table is designed to bring out a few points about the relationship between Government debt, deficits, the money supply, and inflation. Whether the economy has inflation is determined by many forces other than whether the Government runs a deficit; indeed these other forces can well swamp whatever inflationary influence a Government deficit may have.

The rise in price levels the United States has experienced since World War II can be associated with two subperiods. First, during the period between the end of the war and 1950, the suppressed demand of World War II partly worked itself out in higher price levels. During this period, substantial budgetary and cash surpluses occurred. The price increases occurred mainly through 1946 and early 1948. From 1948 through the middle of 1950, prices—particularly the cost-of-living index—stabilized; and from 1949 and through the early part of 1950, wholesale prices actually declined. In both 1949 and 1950, Government cash surpluses occurred.

From 1950 through 1958 prices rose due to two forces. First, the Korean war caused rather sharp increases. Second, with the end of the Korean war a rather gradual upward movement in prices began due to the prosperity of 1955 through the middle of 1957 and an associated increase of the money supply. Notice that in 1956 and 1957 the Government ran substantial budgetary and cash surpluses. But there also occurred during this period a healthy increase in the money supply, including time deposits, and a very sharp increase in private indebtedness.

From 1958 onward, prices have remained remarkably stable. The wholesale price index was virtually unchanged from 1958 through 1962. The mild increase in the cost-of-living index reflects mainly the rise in service prices which in turn mirror rising wages. In view of an inherent upward bias in the cost-of-living index and its additional shortcoming of not reflecting the improvement of the quality of consumer products and services, an increase of one point a year in the index hardly provides a symptom of inflation.

Note that during this period of 1958 to 1962 the Federal budget has exhibited substantial administrative and cash deficits, which were induced by recessions and the slow economic growth. Notice also that during this period private debt has increased greatly along with more modest increases in the money supply. The price stability of recent years reflects the slack in the economy due to unused resources. During this entire period of 1947-62 the net Federal debt (that which the Government owes to private individuals and groups, excluding the Federal Reserve banks) has increased very little—only about 9 percent. The increase in private debt on the other hand was over 270 percent, so that in 1962 Federal debt constituted about 25 percent of the total indebtedness (excluding financial liabilities) in the United States as contrasted with 52 percent in 1947.

From these data, one might make the following observations:

(1) There is no simple relationship between Federal deficits and inflation. Our price rises have been mainly associated with war financing and the shortages of output for the private sector that is associated with major military buildups.

(2) The increasing money supply witnessed in the last few years has not produced inflation due to the economy's slack.

(3) There is no clear relationship between the increased money supply and Federal deficits.

(4) The increase in the Federal debt (held by the private sector of the economy) has been modest compared to the increases in both the GNP and total private debt.

## Selected income, price, and financial data, 1947-62

	Gross national product	Real gross national product (1954 prices)	Money supply (cash, demand, and time deposits)	Administrative budget surplus or deficit (-) (calendar year)	Cash surplus or deficit (-) (calendar year)	Wholesale price (1957-59=100)	Cost of living index (1957-59=100)	Net Federal debt <sup>1</sup>	Private debt <sup>2</sup>
	<i>Billion dollars</i>	<i>Billion dollars</i>	<i>Billion dollars</i>	<i>Million dollars</i>	<i>Million dollars</i>			<i>Billion dollars</i>	<i>Billion dollars</i>
1947.....	234.3	282.3	151.1	n. a.	5,700	81.2	77.8	200.0	179.7
1948.....	259.4	293.1	150.0	5,241	8,000	87.9	83.8	192.2	200.9
1949.....	258.1	292.7	150.0	-3,592	-1,300	83.5	83.0	198.9	211.7
1950.....	284.6	318.1	155.6	-432	500	86.8	83.8	196.7	250.9
1951.....	329.0	341.8	163.8	-3,358	1,200	96.7	90.5	183.4	282.2
1952.....	347.0	353.5	171.7	-5,842	-600	94.0	92.5	196.9	306.5
1953.....	365.4	369.0	176.4	-9,157	-7,200	92.7	93.2	201.0	329.8
1954.....	363.1	363.1	183.6	-3,683	-1,100	92.9	93.6	204.3	348.4
1955.....	397.5	392.7	188.2	-2,771	-700	93.2	93.3	204.3	402.5
1956.....	419.2	400.9	191.7	3,779	5,500	96.2	94.7	197.8	439.4
1957.....	442.8	408.6	196.0	592	1,200	99.0	98.0	195.6	467.8
1958.....	444.5	401.3	209.3	-7,088	-7,500	100.4	100.7	202.3	498.9
1959.....	482.7	428.6	212.2	-7,040	-8,000	100.6	101.5	210.7	548.5
1960.....	503.4	440.2	216.8	1,953	3,500	100.7	103.1	207.9	583.1
1961.....	518.7	447.9	231.2	-6,506	-6,500	100.3	104.2	213.1	623.8
1962.....	553.6	477.5	248.2	-7,199	-5,700	100.6	105.4	217.6	671.9
Changes:	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>			<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
1947-62.....	136.3	67.0	64.2			23.8	35.0	8.8	273.9
1947-50.....	21.5	12.8	3.0			7.0	7.7	-4.4	39.6
1950-58.....	56.5	28.4	34.5			15.7	20.1	2.8	98.8
1958-62.....	24.5	11.7	18.5			-2	4.7	7.6	34.7

<sup>1</sup> Includes Federal debt held by private individuals and groups but not held by Federal Reserve banks which are Government instrumentalities. Excludes also Federal debt held in Government trust funds. Concept of net debt represents that portion of the Federal debt held by strictly private individuals and institutions. It is a more meaningful concept than gross Federal debt if one is concerned with effects upon the behavior of the private sector of the economy.

<sup>2</sup> Private debt includes State and local government, corporate, and individual indebtedness (including mortgage and consumers), but excludes liabilities of financial institutions.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.



Question 21. How many jobs will be created by this bill in 1964? In 1965?

Answer. We anticipate that the tax bill will create as many as 3 million or more new jobs than could be expected without it as its effects work fully through the economy. This creation of new jobs is an essential part of the goal of the tax reduction program—stated another way, our goal is a fully employed economy, capable of absorbing both the current excessive numbers of unemployed and creating jobs for those who will be entering the labor force in substantially greater numbers over the years ahead.

Naturally, the effects of tax reduction on the economy generally and on employment cannot be projected with certainty. But his estimate of enlarged job opportunities is fully consistent with the analysis of the staff of the Joint Economic Committee of the Congress that the direct effects of a \$10 billion tax cut would add perhaps \$40 billion to total national output.

In the shorter run, in 1964 and 1965 before the full effects on jobs are felt, the impact would naturally be smaller—more on the order of up to 1 million in 1964 and 2 million in 1965. But judgments on that score are heavily dependent upon how one assesses the prospects for a recession at some time during this period in the absence of a tax cut. If the tax cut enables us to avoid a recession, that alone could mean that the tax program could be responsible for as many as 2 million jobs even in the rather short run.

Question 22. Will these jobs be created in industry or the service area?

Question 25. Will increased consumer expenditures, dollar for dollar, create more jobs in industry or in services?

Answer. Tax reduction will generate a major increase in effective consumer purchasing power, which will raise the level of demand for virtually every commodity and service we can produce. Also, by encouraging risk taking and investment in new industries and products, tax reduction will create the possibility of new patterns of consumer demand.

The commodity-producing industries have been characterized since the mid-1950's by more limited demands, despite substantial improvement in productivity and capacity. On the other hand, overall growth in services has been at a much steadier pace.

It is not possible to provide forecasts with precision as to the allocation of the increased consumer demand, yet tax reduction can be expected to create the much-needed demand for the existing and new products of the commodity industry—particularly durable goods that typically respond promptly to overall improvement in business activity. At the same time, the tax reduction program will undoubtedly further increase the demand for services, although the impact in many service areas may be less pronounced than in durable goods.

Questions 23 and 24. Have you taken into account the higher productivity and loss of jobs through automation which may be brought about by increased capital expenditures?

Do you accept the Department of Commerce figure of 200,000 jobs now being lost annually because of automation? Are you familiar with the 2 million figure cited by Mr. John I. Snyder, Jr., president of U.S. Industries, Inc.?

Answer. There will, of course, be higher productivity in the years ahead. There is every reason to expect that this growth in productivity will continue as it has in recent years, i.e., 2½ percent a year since World War II. Some of this has been particularly related to what is commonly called automation and some of it is related simply to more efficient use of manpower, interindustry shifts, etc. The principal consequence of this increase in productivity is that we need an increase in market demand each year in order simply to maintain the present level of employment. A 2½-percent annual increase in productivity means that a given amount of GNP can be produced with 2½ percent less man-hours than was the case the year before. The fact is that in recent years demand has not been increasing fast enough to provide jobs for both the growth in the labor force and for workers displaced by increasing productivity. This is one of the basic reasons why a tax reduction is needed at the present time.

It is something of a counsel of despair to argue that because new capital investment is related to increased productivity that we should be concerned about increasing investment. This was the argument raised at the beginning of the industrial revolution. A more promising approach to these problems is to make sure that we have an adequate increase in demand at the same time that we have this increase in capital expenditures. In this regard I can only say that the tax program of the administration is balanced. As you know there are many people who argue that the tax reduction should be concentrated on business taxation in order to increase capital investment. There are others who argue

that it should be concentrated entirely on consumption in order to increase this demand. As an economic matter, I think both are necessary and about in proportions that are provided by the House bill.

Question 26. You state that this bill will enable us to "compete more effectively in international trade." Assuming that foreign countries maintain current attitudes toward restricting imports of goods and outflow of capital, is it likely that we can achieve a balance in our international payments within the next 2 or 3 years, with or without this bill?

Answer. I am confident that over the next several years we will be able to restore substantial balance to our international payments. In addition, I am confident that this particular tax bill will make a substantial contribution to the restoration of that balance, particularly in the field of capital flows. Of course, other efforts will be necessary, and other efforts are being made.

Question 27. You state (p. 6) that State and local governments "will be better able to support badly needed public facilities and services" if this bill is passed. Do you mean to imply that Federal payments to States and local governments for various existing or projected programs will be reduced?

Answer. I do not, of course, mean to imply anything regarding the magnitude of Federal payments to States and to local governments. These payments are matters of law and they will not be reduced unless Congress sees fit to reduce them. What I have in mind is that the present pressure on State and local governments to find new and additional sources of revenue will be reduced by the increase in their revenues from normal sources as the economy expands under the impetus of the tax cut. This enlarged revenue will also enable State and local governments to undertake much-needed projects that would otherwise be beyond their means.

Question 28. In connection with broadening the list of recipients of the additional 10-percent deduction for contributions to charities, will this indirectly benefit those who regularly contribute to "private" foundations? Will those who so desire now be able to contribute 10 percent to "legitimate" charities and still set aside 20 percent in a "private" foundation? Does this bill properly define "private" foundations? Would you care to comment on Congressman Patman's recent comments on the Treasury's foundations probe?

Answer. This will not indirectly benefit those who regularly contribute to private foundations. At present there are a number of organizations, including colleges and universities, churches, hospitals, and medical research organizations to which a 30-percent contribution limit applies. The effect of broadening the organizations eligible for this extra 10-percent deduction is probably merely to shift a little of the extra 10 percent giving from those organizations presently eligible to the new organizations becoming eligible. We do not anticipate that there will be any noticeable increase in the total volume of giving. Those who desire to set aside 20 percent in a private foundation do so today and if they wish to give an extra 10 percent to public organizations they are able to do so. We do think that the bill properly excludes private foundations from the benefit of the extra 10-percent limitation by requiring that the recipient organization of the charitable contribution normally receive a substantial part of its support from the general public or from a governmental unit, such as a city or State. As for Congressman Patman's recent comments on the Treasury's foundations study, we have announced the members of an informal advisory group representing a broad spectrum of those knowledgeable in foundations who are advising us. If we are to study wisely the problems with respect to foundations it is important that we have this broad representation and that we study all sides of the picture.

The members of this advisory group are: F. Emerson Andrews, director of the Foundation Library Center (New York City); Leigh Block, president, Inland Steel-Ryerson Foundation (Chicago); Morris Hadley, chairman, Carnegie Corp. of New York; Barklie M. Henry, vice president, John Hay Whitney Foundation (New York City), and vice chairman, Carnegie Institution of Washington, D.C.; Harry Mansfield, attorney, Ropes & Gray (Boston); Henry A. Moe, retired president of Guggenheim Memorial Foundation (New York City); Robert Mueller, attorney, Mueller & Criss (Austin, Tex.); James Patton, president, National Farmers Union, and president, Farmers Educational Foundation (Denver); Harry J. Rudick, attorney, Lord, Day & Lord (New York City); Albert Sacks, professor, Harvard University Law School; Jack S. Seidman, accountant, Seidman & Seidman (New York City); Walter M. Upchurch, Jr., vice president, Shell Companies Foundation (New York City); David Watts, attorney, Dewey.

Ballantine, Bushby, Palmer & Wood (New York City); Donald Young, president, Russell Sage Foundation (New York City). Prof. Bernard Wolfman, University of Pennsylvania Law School, is also participating as a consultant.

Question 29. Do you support the bill's group term life insurance provision? Would you support a reduction of the \$30,000 figure in the bill to \$5,000?

Answer. As I stated with respect to a number of other provisions of the House bill that differ in some respects from our original recommendation, we would have preferred to see them otherwise. In fact, the group term provision of the House bill is a good one because it will curb the abuses in the group term insurance area by taxing the cost of insurance provided in excess of \$30,000. If the committee were to set a \$5,000 limit, this would be aimed not merely at abuses but also at a broadening of the tax base for all employees. While the \$30,000 limit is very simple to administer because it applies to perhaps slightly over 200,000 out of 43 million employees covered by group term insurance, a limit of \$5,000 would bring in many more employees. The Ways and Means Committee felt that the possible complications involved in covering more employees were not worth the base broadening. We would have supported a decision in accordance with our original recommendation of a \$5,000 limit, but we think that the decision to get at the abuses was a substantial advance over present law.

Question 30. Do you support section 202(e)?

Answer. As I stated in answer to the questioning of Senator Williams, this was not a Treasury recommendation and in fact it is not a matter of basic concern to the Treasury as to how regulatory agencies handle their own job. It was simply a matter of how the Ways and Means Committee felt the intent of Congress last year in enacting the investment credit should be carried out. This is one of the provisions of the House bill that we accepted and we are not asking for any change.

Senator GORE. Thank you, Mr. Chairman. I apologize for taking so much time. I feel so intensely about this, I would really like to take a week.

Senator LONG. May I ask a few more questions?

The CHAIRMAN. Senator Long.

Senator LONG. Mr. Chairman, I have imposed on this committee for only about 10 minutes. I would like to take a few more minutes to ask a few questions which I think, in fairness, should be put to the Secretary.

First let me say that in my judgment the Senator from Tennessee is one of the most valuable Members of the U.S. Senate. I am prejudiced in that respect.

Most people who complain in Government like I do, either don't have enough influence or the people they agree with don't have enough influence; but I want to say that I completely agree with the Senator's views on interest rates, and I agree with him on monetary policy. I do not agree with the Senator on fiscal policy, particularly as it affects this bill.

Now I want to ask you first, Mr. Secretary, how much would your recommendation for withholding tax on interest and dividends last year have raised your estimate?

Secretary DILLON. Our estimate, on the basis of the House bill, was \$780 million.

Senator LONG. And you got beat on that right here in this committee. Now the Senator from Tennessee supported your views and you prevailed in the House. I think in fairness it should be said, or I will ask you, Do you know of any additional efforts you could have waged that you did not exert trying to get that provision last year?

Secretary DILLON. I certainly do not. You can hear the noise from those who worked with us.

Senator LONG. I know as one Senator I think at a time when I was holding the deciding vote against you on that one, and I know that both you and every one of your assistants whom I see sitting there, in one way or the other importuned me to try to get me to vote for it, and even the President tried to persuade me to go with you on that one. The chairman of this committee sitting here was really the man who led the fight to defeat you on that. He gave you something that might help along that line, but it wasn't your fault that you did not get that \$850 million that you thought people were evading.

Secretary DILLON. That is right.

Senator LONG. It was some of us on this committee.

Now last year you were recommending something the Senator from Tennessee was wanting, and you fought for it very hard. You got it through the House to put some very heavy taxes on these Americans doing business overseas. You were defeated in this committee, weren't you? As I recall, I believe that I am the man that made the motion that struck most of that out. But we left you some of it, and on the extreme tax haven cases, I think you got pretty much what you wanted.

Do you know of any lack of diligence on your part or on the part of those associated with you in trying to get that, including the Senator from Tennessee?

Secretary DILLON. No, sir.

Senator GORE. I will go down there and sit by him if you want me to.

Senator LONG. Senator Kerr used to sit here on occasions when we were talking about favored taxpayers, and contend that the building and loans or mutual savings banks were perhaps the most favored taxpayers. Have you succeeded in increasing taxes on them?

Secretary DILLON. Yes, we have.

Senator LONG. And did you succeed as much as you wanted to?

Secretary DILLON. No.

Senator LONG. Whose fault was that, from your point of view?

Secretary DILLON. Well, the Congress would not agree with us.

Senator LONG. The House turned you down part of the way and the Senate turned you down part of the way?

Secretary DILLON. Yes.

Senator LONG. You got something.

Secretary DILLON. We got about half of what we were asking for.

Senator LONG. You did make progress in that respect. How about insurance companies? Have you succeeded in raising taxes on insurance companies?

Secretary DILLON. Yes, we did succeed in raising them on some insurance companies last year.

Senator LONG. So, as a practical matter, you have recommended increasing taxes on practically all segments of the economy which you felt had been favored, and that has included a very broad swath of the business community in general, has it not?

Secretary DILLON. Yes, including the oil industry.

Senator LONG. And I am not in agreement with you on that.

Senator GORE. You know that old story about giving a calf enough rope.

Senator LONG. I don't want to be associated with that recommendation.

I would like to ask if you agree with the Long theory that unrealistic tax rates on income actually bring in less revenue than reasonable rates?

Secretary DILLON. I think that is correct. That is the basic theory of this law which is embodied in the statement in section 1 by the House of Representatives. They feel that by reducing rates to a more reasonable level the economy will be stimulated, and we will actually get more revenue than we would otherwise.

Senator LONG. Mr. Secretary, not only have I done this but I have had other Senators say it before the committee, and I have had more confessed to me in private, that there are many times when legislators have voted for tax advantages favoring various groups because the tax rates were so completely unrealistic that those people could make a good case that they were entitled to some sort of relief.

Now the Treasury for many years opposed H.R. 10. It almost passed over a President's veto, or against the President's recommendation, notwithstanding administration objection to it, because many people felt that doctors, lawyers, and other professional people were being crucified, particularly in comparison with others.

I put a chart in the record yesterday, a Treasury study made prior to the time you assumed your responsibility, indicating that on taxpayers making incomes between \$500,000 and \$750,000, the actual effective rate appeared to be about 53 percent.

However, on taxpayers making over \$1 million, from there on up, in all different groups including those making over \$5 million, the effective tax rate appeared to be around 24 percent which, to me, even though the rate is much higher on that income, to me that indicates that when you get your rate so high that it is unrealistic, people engage in all sorts of tax avoidance arrangements.

I can testify as one person, looking at some of this, that I have been shown how I could engage in a transaction where I could lose money; but what I could make in a tax saving would be so great compared to what I would lose, that as a businessman I would either be foolish or patriotic to go ahead and pay all that money.

Now it seems to me that one of these days we are going to have to recognize that the law should recognize what the facts of life are, rather than simply be self-defeating in how much income we hope to raise in some brackets.

With regard to this chart that the Senator produced, showing how much a person's take-home pay would be increased by a tax reduction, as a practical matter doesn't it leave out so many factors as to be almost meaningless?

Secretary DILLON. Well, we have felt that a more meaningful one was to take adjusted gross income, which would then include all the various changes, deductions, the itemized deductions, the change in the dividend credit and so forth, and that is what all our tables have been based on. We feel that only to look at the rates does not give an adequate or a full picture.

Senator LONG. Now furthermore, suppose you are trying to reduce taxes, based on take-home pay. Let's take a fellow who is in a low-income bracket and paying only 2 percent of his income in taxes, to begin with, how could you possibly reduce taxes in such a way as to

reduce his income tax payment, even if you cut him 100 percent in taxes compared to a man in an upper income tax bracket? A one-fourth of 1-percent reduction on that fellow would still result in a very substantial increase in take-home pay, if he is actually paying 87 percent of his income, would that not be correct?

Secretary DILLON. That is right.

Senator LONG. That is why it would seem to me that while it is useful to consider those factors, if you assume that your tax structure is fair to begin with, and that it is on a reasonably graduated basis, a strong case can be made that if everyone gets the same percentage in tax reduction that it is an equitable reduction, all considered.

Although I realize that someone can argue that it should be the other way, as far as people who are not paying any taxes at all, and some of them are completely eliminated from the groups of taxpayers by this bill. There would be no way that a tax cut could reach them if you wanted to raise their take-home pay. I assume you would have to go to subsidy for them, would you not?

Secretary DILLON. That would be right, because there are many nontaxable people. Actually, all the people, the average man, the average worker never pays tax on taxable income beyond the first bracket, which is the \$2,000 bracket. because if he is married, that would cover an income up to nearly \$6,000—and if he has an average family of two children—it would cover an income up to somewhat over \$7,000.

So the special extra advantages that we have given there are very meaningful for the great mass of the working population of this country, and the people who pay taxes above that are a minority.

Senator LONG. Mr. Secretary, in fairness I think as one person I should say that if you think you are unpopular with the economists and Government theoreticians because you haven't prevailed in more tax reforms, you have no idea how unpopular you would be if you had prevailed in all those.

The CHAIRMAN. Mr. Secretary, I think as long as I have been pictured as the villain who had some responsibility at least for the defeat of the withholding tax on interest and dividends, I should call to the attention of all that two votes were had on the floor of the Senate. On one occasion 18 votes out of 100 were cast in favor of withholding, and on another 20 votes. So the Senate Finance Committee and the chairman of this committee are not wholly responsible for the defeat.

It also should be said, I think, that a substitute plan was adopted whereby every taxpayer was given a number, they have computer machines, and that I understand substantial progress is being made in now collecting the taxes that were avoided by those who should pay taxes on dividends and interest.

I was told that only recently by the collector of internal revenue, and I want to ask if that is not your belief also, that progress is being made to eliminate this avoidance of tax on the part of those who receive dividends and interest.

Secretary DILLON. Undoubtedly, Senator, progress is being made. It is difficult to measure the exact amount because we can only wait until we get the statistics on that which always lag by a couple of years.

But great progress has been made in getting the account number system working, and it is in effect now, and I think that part of it we know has worked, and it is a question as to how much that will bring in. Time will tell that. In 3 or 4 years we will see where we are.

The CHAIRMAN. It is also true that a heavy penalty was imposed for those who did not.

Secretary DILLON. Yes.

The CHAIRMAN. We don't want to thrash over an old story. I just simply wanted to make that statement for the record.

Now, Mr. Secretary, we thank you very much, sir. You have been very anxious, I believe, to give a fair statement of this bill. I want to say that we are through with you for the present.

Secretary DILLON. Thank you, sir.

The CHAIRMAN. If we need you again, we will let you know.

Senator GORE. What about Senator Talmadge?

The CHAIRMAN. Does he desire to ask questions?

Senator GORE. He told me he would like about 10 or 15 minutes, and I apologize for taking so long.

The CHAIRMAN. That could be done tomorrow morning, I suppose. I forgot the fact he told me he wanted to ask some questions.

Senator LONG. Might I suggest that the Secretary make himself available for perhaps a half hour tomorrow, he might answer questions by Senator Dirksen and Senator Talmadge.

Senator GORE. I know Senator Talmadge spoke to me and said he did have some questions.

The CHAIRMAN. You are right. He mentioned that to me.

The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:55 p.m., the committee adjourned to reconvene at 10 a.m., Friday, October 18, 1963.)





# REVENUE ACT OF 1963

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FRIDAY, OCTOBER 18, 1963

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

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long presiding.

Present: Senators Long of Louisiana, Smathers, Talmadge, Williams, Bennett, Curtis, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

Senator LONG. I am calling this committee hearing to order. The chairman is necessarily absent this morning.

Mr. Secretary, we appreciate your coming back this morning to make yourself available to Senators who had not had a chance to interrogate you with regard to your views.

I believe that Senator Bennett would have been next. In Senator Bennett's absence, Senator Talmadge is recognized.

Senator TALMADGE. Mr. Chairman.

Mr. Secretary, first I would like to compliment you, sir, on your presentation, particularly the fact that you submitted it to the committee in advance. I took my copy home and read it in detail, and I found it extremely helpful in trying to analyze and understand some of these many complex changes in the law.

I found, for instance, the appendix, tables, and explanations connected there were very helpful in understanding some of the more complex provisions that would confound even a tax lawyer himself.

I wanted to ask you a few questions this morning, Mr. Secretary. I shall not detain you long. You have been very patient. You have been before this committee now an entire week, and I can understand what a trying experience that would be.

You addressed yourself, in your initial testimony to this committee, about the necessity for keeping a tight rein on the expenditures. Just what do you mean by "tight rein"?

## STATEMENT OF HON. C. DOUGLAS DILLON, SECRETARY OF THE TREASURY—Resumed

Secretary DILLON. I think, Senator, "tight rein" means that the Congress and the administration, the Executive, should lean over backward to hold expenditures down, that they should discontinue programs that are no longer necessary, and that they should limit increases to the absolute minimum.

Now there have been a number of studies made of our budget by various Budget Directors. The latest one is the one that was made

by Mr. Maurice Stans just before he left, who was the Budget Director under the last administration. In this study they came up with some admittedly rough figures, but the best Budget Bureau could put together, indicating that because of natural growth in population, expenditures were apt to grow and would grow without any new programs and new efforts by about something like \$2.5 billion a year in normal times. This takes care of the additional number of people that get veterans' benefits as they grow older, and the greater cost of carrying more mail and various things of that sort that are built into our growing economy.

We do feel, as the President has stated in his original message and has repeated many times, that we can achieve a balanced budget, should achieve it, by an expenditure restraint which would keep our growth in expenditures in future years to that level, if you can keep them level for 1 year that would be fine, but thereafter they would have to grow. If we keep the growth in expenditure to a level like that, which is considerably less than normal expected growth in revenues, the difference between the growth in revenues which would be \$5 or \$6 billion a year, and the growth in expenditures of half of that or less, would enable us, over a period of about 3 years, to reduce this deficit of some \$9 billion that we envisage with the tax plan fully in effect in fiscal 1965, to a balance.

That is basically what we have in mind.

One other thing I would just like to mention is the key importance here of appropriations. There has been much discussion about the question of actual expenditures, and a lot of attention focused on the figure of Government expenditures in a given year, particularly this year where they are going up substantially, our estimate being around \$98 billion as compared to \$92.6 billion last year. Many wonder why that cannot be cut back substantially.

Our original estimate was \$98.8 billion and it has been cut back now to something like \$98 billion. There is a very interesting discussion of these expenditures by Mr. Cannon, the chairman of the Appropriations Committee of the House, where he pointed out that only 45 percent of the funds that will be spent this year are funds that will be part of the amounts that are appropriated this year. The rest of them, 55 percent, come from the actions of the Congress in past years or from the continuing appropriations, primarily the appropriation for interest on the public debt.

In the cuts which are being made in this year's appropriations, which Mr. Cannon estimated would total something near \$5.4 billion by the end of the year, only a very small part of those would affect expenditures in this year. The rest of it would affect expenditures in succeeding years. So I think that when one talks about expenditure control and restraining expenditures, one wants to be realistic. One should look at where expenditures come from, which is appropriations, and if we can have a good record, which I think the Congress is making this year, of holding down appropriations so that there is no increase, or only a very minor increase, over the level last year, we will have achieved the objective that so many of our citizens strongly desire, namely, that when we have a tax cut we should hold expenditures. We will be doing that.

That will not at the same time hold down the actual checks that we are writing, which are based on appropriations that were made in the past. In this connection, however, I think the only other comment I would make is that the President has never felt he could take unto himself—and I think there would be strong opposition in many parts of the Congress if he did—the authority to take these appropriations that have been voted and approved and not spend them in varying amounts in various areas. If he just decided that he did not want to do a particular public works project in a particular area for some reason, and he just refused to do it, if he carried that out widely throughout the country that would be in effect an item veto, which Presidents have asked for and which I think would be a very useful economic tool, but which Congress has very strongly resisted giving to the President.

Presidents have felt they do have this power in the defense field, because, as Commander in Chief, they have certain extra responsibilities and extra powers, and have withheld expenditures in that area. But once a program is voted, it is very unclear that the President has any extensive power to just cancel that program and say: "I am not going to spend the money."

Senator TALMADGE. I take it from your response then that you do not envision a reduction in expenditures.

Secretary DILLON. I do not envisage an absolute reduction in expenditures. I think that the regular appropriations for this year may or may not be less than those for last year. It will be a close thing.

Mr. Cannon reported, in his report that I referred to, on the first four major bills which have now become law totaling some \$60 odd billion in appropriations, over two-thirds of the budget, and they total \$339 million less than was appropriated for the same agencies last year. So if that record is continued—and he has so stated that he thinks that this is a likelihood, and I know no one who is in a better position to have an opinion—we may well find that we will appropriate less money this year in our regular appropriations than we did last year. But that does not mean that the total of actual expenditures will come down, because they still have to catch up to the very large increases in appropriations that were voted in previous years, particularly in the area of defense and space.

Senator TALMADGE. When you speak of maintaining a tight rein on expenditures then, I take it from your reply that you mean substantially resisting new or additional programs.

Secretary DILLON. I think that is correct.

Now, in addition, the President has put into effect a very strict program throughout the Federal Government of personnel control, and certainly the strictest program that has been in effect that I know of. The results of that—it started last fall, it has been carried on—the results are showing.

For the fiscal year, the year ended June 30, 1963, on that June 30 there were only some 5,600 more employees than there were the year before. That progress has continued. The Budget Director informed me the other day that he had received figures for the end of August, which showed that as of the end of this August there were only, I

think the figure was 78 more employees on the Government payroll than a year earlier.

Looking at the growth of the country, the necessity to have more revenue agents, to have more postal carriers, that shows there have been substantial reductions in other areas to hold that level, and this is an indication of a very tight control of expenditures.

Senator TALMADGE. I take it that the main thrust of your argument for a tax reduction was to stimulate the economy, to help unemployment, and ultimately to balance the budget; is that correct?

Secretary DILLON. That is absolutely correct.

Senator TALMADGE. I do not think there is any doubt but what a tax reduction would stimulate the economy, would aid unemployment, but I am somewhat leery about how it is going to balance the budget.

Now what do you anticipate the level of expenditures will be in fiscal year 1964, which will be June 30 of next year?

Secretary DILLON. I have stated, and I think the Budget Director, who is here to testify and will follow me, will maybe have more complete figures on that, but I stated some time ago that I felt the level of expenditures would be in the area of \$98 billion, which is some \$800 million less than was in the President's budget submitted in January.

Senator TALMADGE. What do you anticipate the income to be for fiscal year 1964, assuming the Congress passes the bill before us now in substantially its present form?

Secretary DILLON. In substantially its present form we have not made a detailed further analysis of income recently, but we have analyzed, we have taken account of the fact that business this year has done better than it did before, and because of that, revenues will be ahead, and we have added \$1 billion therefore to our original estimate. Based on that, our estimate shows \$88.8 billion as our current estimate. I would hope, if business conditions continue successfully, we might do slightly better than that, but that is our current estimate.

Senator TALMADGE. That would be a deficit then of about \$9.2 billion?

Secretary DILLON. Yes. That is the figure that we have used and now expect, rather than the \$11.9 billion that had been estimated in the budget, because of a better business conditions, because of reduction in expenditures, and because of the fact that the starting date of the tax cut is now set at January 1. It just so happens that \$9.2 billion was the original estimate for the deficit for this year without any reduction of revenues from the tax cut. So we can in effect come out where we thought we were last January with a tax cut, and pay nothing for the tax cut.

Senator TALMADGE. Then if the Congress does not pass this tax bill, what do you think the deficit will be June 30 next year?

Secretary DILLON. Our estimate of the cost of the tax bill this fiscal year is \$1.8 billion, and so theoretically the deficit would be that much less. I say theoretically because I think that the country has built a lot of expectations of the tax cut into the business atmosphere of the country, and if there were no tax cut, and the bill were defeated, I think there would be great disappointment, and that would very likely lead to a slowdown of business, which would naturally also reduce revenues, and I think we would begin to feel some of those effects in this fiscal year.

Senator TALMADGE. You think the deficit would be about \$1.8 billion less without a tax reduction?

Secretary DILLON. That is right, subject to that reservation.

Senator TALMADGE. Now let's move on to fiscal year 1965. I know it is sometimes difficult to try to make projections in the future.

What would you estimate the level of expenditures in fiscal year 1965 to be?

Secretary DILLON. The budget process is still underway. I am sure the Director of the Budget, who as I say will follow me, who has been concerned with this over these immediate months and is working on it right now, will be in a better position to answer that question. However, because of the fact that appropriations in 1963—that is last year, fiscal 1963—were something like \$101.5 billion, and if we hold that level this year—as I was saying earlier, it would be the same—everything would point to the fact that an expenditure level of something like \$98 billion would have to increase to approach the level that had been actually appropriated as a ceiling. That is just the inevitable lag in time.

So I am sure there will be some increase in expenditures. However, the President has issued very strict orders, he has made a public commitment that the deficit he will estimate will not be more than the \$9.2 billion that we now estimate for this year. This is including the fact, which we have to take into account, that the fiscal year 1965 will be the year in which we receive the maximum impact on our revenues from tax reduction. The full effect of 1964 corporate reduction will be in effect, the full 1964 rate reduction on personal incomes will be in effect, and we also will have half of the 1965 reduction, since the withholding rate will go down to the permanent level in fiscal year 1965. So that is the year we expect to have the greatest reduction in revenues from the tax bill, and we do expect that the net figure of reduced revenues, because of the tax bill, will be something like \$3.5 billion that year as compared with \$1.8 billion which I just mentioned for 1964.

But in spite of that increase, the President feels and has made a pledge, a commitment, that he will not present a budget that has an expenditure total which leads to a deficit of more than \$9.2 billion.

Senator TALMADGE. Would you think an expenditure of something on the order of \$102 billion would be a reasonable estimate for fiscal year 1965?

Secretary DILLON. You ask that question presumably because it was stated widely in the press that I made such an estimate in the House Ways and Means Committee in closed session. Actually, I never made any such estimate. What I did was to answer some hypothetical questions that were put to me by a member of the Ways and Means Committee who took the \$98 billion figure for this year and added to it \$1 billion, which was his own estimate, and presumably a relatively accurate estimate of the increase in space expenditures that are due to the appropriations that are already in the pipeline, even assuming a fairly drastic cut in the appropriation this year. He then added on top of that the figure that Mr. Stans had used, \$2½ to \$3 billion for normal increases, which then gave him a total increase of \$3½ to \$4 billion, and he came up with \$101.5 or \$102 billion as a total. He asked me if that was proper arithmetic and I said it was, but I tried to

indicate that the President and the Director of the Budget were going to use every effort to hold the figure as low as possible, and that we did not agree necessarily that in this particular first year we would have to have an increase as large as that which Mr. Stans in the budget study had said was the normal increase. But we were not able to make an exact estimate.

I am certainly not able to now, and I do not think Mr. Gordon will be either. But he will know much more than I do about that.

I would certainly say that \$102 billion would be a very outside figure. I do not think we would go beyond that under any circumstances.

Senator TALMADGE. And if the tax bill is passed, what would you estimate the revenues would be that would come in in 1965?

Secretary DILLON. If our expenditures are \$102 billion, the revenues would have to be not more than \$9.2 billion less than that, which would get you down to something like \$93 billion, a little under \$93 billion.

Senator TALMADGE. Do you estimate the income in accordance with what we spend or what the bill would be as a percentage of the gross national product?

Secretary DILLON. No, I will turn the thing around and do it the other way. Then we come to a different expenditure estimate.

We estimate this year that we will have revenues of \$90.6 billion that will be reduced by \$1.8 billion as a result of the tax bill to \$88.8 billion. Let's take that \$90.6 billion, which is without the tax bill. If there is a normal increase in our growth, in other words, if we continue to grow at 3 percent, which is the average relative real growth we have had in past years, the amount of revenue that could be expected to be added would be \$5 billion. So the figure would be \$95.6 billion.

Now, that figure will be reduced in our estimate by the 1965 loss from the tax program, which is \$3.5 billion. If you take that off, you come to a figure of about \$92 billion. So I think that while we have made a gain—this is just on the assumption of normal growth, we have not made new revenue estimates in detail. When we do, it may be somewhat different, but taking this, you come to a figure of \$92 billion, or \$92.1 billion, and if you add your \$9.2 billion figure on that, that would put a ceiling on expenditures of somewhere just barely over \$101 billion.

Senator TALMADGE. So the deficit then for the fiscal year 1965 if the tax bill is passed would begin the neighborhood of \$10 billion, and if the President wanted to hold it to not less than \$9.2 billion, he would have to reduce the expenditures from \$102 billion; is that correct?

Secretary DILLON. With these revenue figures it would have to be less on that basis and he has made that pledge, so that I do not think that \$102 billion estimate of expenditures is any firm estimate.

I explained to you how it arose. It was in answer to a series of questions from a member of the Ways and Means Committee who built up a hypothetical possibility, and I had to say that, based on estimates that Mr. Stans had made in the past, and the special situation in the space program, that that was an estimate that a reasonable man could put forward.

Senator TALMADGE. Now assuming the tax bill is not passed, what would you estimate the deficit to be in the fiscal year 1965?

Secretary DILLON. There I would have a difficult situation, because I am certain then that the regular growth pattern that would lead to a \$95.6 billion revenue would not continue. It would be the most unusual circumstances that could see that continue, because our recovery has been full length already, and in effect one might say we are living on a certain amount of borrowed time, although I do not see an immediate downturn.

But I think it is significant in that the National Association of Business Economists, which met about 2 or 3 weeks ago, which are the leading economists who work for big business and advise big business on their sales prospects over the years ahead, did make an estimate. They estimated that, in the absence of a tax cut, the gross national product would be \$12 billion less than it would be otherwise, that we would have a practically flat economy, or no growth in national product and with no growth at all in revenue in the latter part of 1964, and that probably we would see a recession in the early part of 1965. So that would mean that our revenues, instead of growing \$5 billion, might not grow at all.

The last time we had a setback, in 1960, revenues were almost identical with the year before. They went down I think \$100 million. In that event, our deficit without the tax cut could well be as much as \$10 to \$12 billion.

Senator TALMADGE. In other words, 1965, taking into consideration the fact that you may have a depression—

Secretary DILLON. A recession.

Senator TALMADGE. A recession, the deficit may well be as great in 1965 without a tax cut as it would be with a tax cut; is that correct?

Secretary DILLON. In my own personal opinion—and this is a difficult thing to venture because there are so many variables—my own personal opinion is that it would be larger.

Senator TALMADGE. Let's get to the year 1966 now. I realize, of course, we are dealing in many imponderables here, but most of this is based on imponderables.

Secretary DILLON. That is right.

Senator TALMADGE. And we have to get into the realm of speculation.

What do you anticipate the level of expenditures of Government to be in 1966 fiscal year?

Secretary DILLON. I have no figure for that except that again we have said that defense expenditures have more or less leveled off, that space expenditures after another sharp increase which we foresee in 1965 should begin to level off, and other expenditures we would hold to the tightest levels possible, so that we could get the benefit of the increased revenues from the tax cut. Certainly I would see a reduction of the deficit, a sharp reduction in 1966.

If you say you have an overall increase in expenditures of \$2 to \$3 billion, an increase in revenues of \$6 billion, we would pick up some \$3 billion a year. I would think this would continue, and this is the reason why I think that a deficit of around \$9 billion in 1965 could be converted into a balanced budget by 1968 at the latest by a continual reduction of \$3 billion or more in the deficit each year.

Now, if you did not have a tax cut, which is the obverse of that, there is no doubt whatsoever that we would have a setback in our

economy, and I do not think past history leaves any doubt whatsoever as to what the reaction of the people and of the Congress to that would be. It would be a massive increase in Government expenditures comparable at least to the \$6.5 billion in additional expenditures that were voted in 1958 to try and handle the recession that was then present, and I would foresee deficits of very large amounts during that period of recession.

It would be easy to contemplate deficits in the area of \$15 billion and upward.

Senator TALMADGE. What would you estimate the level of expenditures to be for fiscal year 1966?

Secretary DILLON. I have no estimate, as I said, Senator.

If you take a figure of whatever they are in 1965, whichever one you prefer, \$101 or \$102 billion, something like that, and add \$21½ or \$3 billion to it, that would be the normal increase.

Senator TALMADGE. About the normal order of \$105 billion then. Then what would you estimate the income to be under the tax bill at that time?

Secretary DILLON. At that time it would be something in the neighborhood of very close to \$100 billion, something like that. That would be close.

Senator TALMADGE. You would have a deficit on the order of \$5 to \$6 billion then in fiscal year 1966?

Secretary DILLON. That is right.

Senator TALMADGE. What do you estimate the deficit would be if the Congress did not pass this tax bill?

Secretary DILLON. As I said, there I am very certain that we would be suffering a downturn, and it would have an effect that would be comparable to 1959 in the cycle. We would be coming presumably out of a recession. As a result of having taken action and increased expenditures, but with less revenues, I would foresee a deficit running anywhere from \$15 to \$20 billion.

Senator TALMADGE. So you think the fiscal year 1966 then is the year when we will stop having diminishing returns on this tax bill, and the level of expenditures will then approach the income which would be generated by the tax bill.

Secretary DILLON. That is the time when I would think we would begin to move toward balance noticeably, and that that would continue in the next 2 or 3 years.

Senator TALMADGE. Do you think then as a matter of certainty that, assuming the level of expenditures increased by 2 to 4 percentage points annually, that the budget would be balanced in fiscal year 1968? Is that your estimate?

Secretary DILLON. Yes, I have said that it could be balanced in 1967 with good luck—by “good luck” I mean a somewhat greater, a fortunate increase in our economy, if it grew a little more rapidly. We have tried to be relatively conservative in our estimates for that. I think in 1968 there is no reason why it should not be balanced then. I have always said the period 1967 and 1968.

Senator TALMADGE. Assuming the tax bill is passed, what economic effect will its reduction in taxes have on the budgets and incomes of municipalities, counties, and States?



Secretary DILLON. In the various States we were asked to make a study by the Joint Economic Committee, which furnished us with the assumption that a \$10 billion tax cut would over a period of years, 2 or 3, stimulate our economy, our gross national product, by \$40 billion. Our own figures are that this is about right. It might even be a little larger. We might be a little more optimistic.

Senator TALMADGE. How many years will it take to generate that?

Secretary DILLON. I would say about 3 or 4. We broke this \$40 billion figure down into the personal income increase in each State, which figures we have put in the record, and through that were able very easily to indicate how State revenues would increase and local revenues would increase under present tax systems without the initiation of new taxes. The figure came to something in the neighborhood of \$2.9 billion.

That table is in the record of the Joint Economic Committee. We would be glad to put it in the record of this committee. The difference would be split almost equally between States and localities. The State increase would be \$1.5 billion and the increase in local revenues would be \$1.4 billion.

Senator TALMADGE. Do you have any estimate there on what it would do to the State of Georgia's revenue?

Secretary DILLON. Yes, sir.

The State of Georgia, the increase in State and local tax revenues, our estimate is \$42 million.

Senator TALMADGE. How much would be provided to the State and how much to the counties and the municipalities?

Secretary DILLON. It happens that—probably because the State of Georgia has a somewhat different system of taxation—that the figure would work out a little differently than the average. For the State of Georgia there would be a \$29 million increase for the State, and only a \$13 million increase for the localities. So the State would get about two-thirds rather than about half, which is the national average.

Senator TALMADGE. What particular year do you anticipate State revenues would be increased \$29 million, local revenues \$13 million.

Secretary DILLON. This would be after this \$40 million had worked out, which would probably be in about 1967, I would say.

Senator TALMADGE. Thank you very much, Mr. Secretary. I have no further questions.

Secretary DILLON. Can I put this in the record?

Senator SMATHERS. If there is no objection, we will put that in the record, the statement of income of the various States.

(The statement referred to follows:)

Effect of a \$10 billion Federal tax reduction on State and local tax revenues (based on Joint Economic Committee staff projections of increases in gross national product)

[Amounts in millions]

State	Increase in total State and local tax revenues		Increase in State tax revenues										Increase in local tax revenues	
			Total		Sales and gross receipts		Individual income		License		Other			
	Amount	Percent of 1962 revenues <sup>1</sup>	Amount	Percent of 1962 revenues	Amount	Percent of 1962 revenues	Amount	Percent of 1962 revenues	Amount	Percent of 1962 revenues	Amount	Percent of 1962 revenues	Amount	Percent of 1961 revenues
Alabama.....	\$32	8	\$24	8	\$16	7	24	14	\$2	9	\$2	7	\$8	7
Alaska.....	4	8	3	8	1	9	31	8			1	8	1	7
Arizona.....	23	7	14	7	9	7	22	13	(1)	7	2	8	9	8
Arkansas.....	19	8	15	8	11	9	1	8	1	9	1	6	9	8
California.....	404	8	198	8	104	8	32	11	14	7	48	10	206	8
Colorado.....	35	8	19	8	7	6	29	14	2	7	1	3	16	8
Connecticut.....	45	7	21	7	15	7			1	5	5	8	24	7
Delaware.....	7	6	6	7	2	9	2	6	1	5	1	7	1	5
Florida.....	79	8	42	7	31	7			7	8	4	9	37	8
Georgia.....	42	7	29	7	23	8	5	11	(1)		1	4	13	6
Hawaii.....	10	6	8	6	5	5	62	7	(1)		1	12	2	6
Idaho.....	10	8	6	8	1	4	23	14	2	12	(1)		4	7
Illinois.....	161	7	65	7	54	7			9	7	2	6	96	7
Indiana.....	64	7	29	7	25	7			4	7	(1)		35	7
Iowa.....	47	7	22	8	12	7	26	12	4	8	1	6	25	7
Kansas.....	37	7	15	7	9	6	23	11	2	6	1	4	22	7
Kentucky.....	29	7	19	6	10	5	24	11	2	9	3	7	10	7
Louisiana.....	43	7	31	6	12	6	2	11	3	7	14	7	12	7
Maine.....	13	7	7	8	6	8			1	6	(1)		6	7
Maryland.....	48	7	27	7	16	7	7	7	2	6	2	5	21	7
Massachusetts.....	95	7	42	8	15	8	20	11	5	4	2	4	53	7
Michigan.....	158	8	94	9	73	10			12	8	9	6	64	7
Minnesota.....	62	7	32	8	8	6	16	13	4	7	4	5	30	7

Mississippi.....	19	6	12	6	8	5	1	13	1	6	2	7	7	7
Missouri.....	57	7	28	7	17	7	26	8	4	7	1	4	29	7
Montana.....	13	8	8	11	4	12	2	13	1	11	1	6	5	6
Nebraska.....	18	7	7	7	4	8	-----	-----	1	8	2	7	11	6
Nevada.....	7	8	4	8	3	8	-----	-----	(*)	-----	1	8	3	8
New Hampshire.....	8	7	3	7	2	7	-----	-----	(*)	-----	1	6	5	7
New Jersey.....	116	8	36	8	23	9	-----	-----	10	8	3	5	80	7
New Mexico.....	13	7	9	7	5	7	26	8	1	6	2	6	4	8
New York.....	410	8	201	9	62	9	102	10	14	7	23	5	209	7
North Carolina.....	52	7	37	7	22	7	7	7	5	8	3	4	15	8
North Dakota.....	9	7	4	6	2	6	(*)	-----	(*)	-----	2	7	5	8
Ohio.....	137	7	61	7	46	7	-----	-----	12	7	3	6	76	7
Oklahoma.....	29	6	20	6	11	6	3	10	3	6	3	5	9	6
Oregon.....	34	8	21	10	3	6	13	14	3	7	2	7	13	7
Pennsylvania.....	136	6	75	6	54	6	-----	-----	10	5	11	5	61	6
Rhode Island.....	13	7	7	7	5	7	-----	-----	1	8	1	8	6	7
South Carolina.....	22	7	17	7	14	8	1	4	1	5	1	5	6	6
South Dakota.....	11	7	4	7	3	7	-----	-----	(*)	-----	1	8	7	7
Tennessee.....	35	7	20	6	13	6	-----	-----	4	7	3	8	8	8
Texas.....	126	7	66	7	36	7	-----	-----	22	13	3	3	60	8
Utah.....	16	8	9	8	5	8	2	12	1	9	1	5	7	8
Vermont.....	6	7	4	8	2	9	1	8	1	10	(*)	-----	2	5
Virginia.....	43	7	24	7	14	9	6	7	3	6	1	2	19	8
Washington.....	48	6	34	7	29	7	-----	-----	2	5	3	6	14	6
West Virginia.....	17	6	12	6	10	6	3	5	1	5	(*)	-----	5	6
Wisconsin.....	68	7	35	8	11	7	13	9	4	7	7	7	33	7
Wyoming.....	5	6	3	7	2	8	-----	-----	1	9	(*)	-----	2	6
Total.....	2,935	7	1,529	7	875	7	277	10	186	7	191	6	1,406	7

<sup>1</sup> The increase in local tax revenues is based on data for 1961 which is the latest year available.

<sup>2</sup> Includes revenue increase resulting from deductibility of Federal income tax liability in the computation of the State income tax.

<sup>3</sup> The individual income tax in Alaska and West Virginia is imposed as a percentage of the Federal income tax. West Virginia has fixed its rates as a percentage of the present Federal rates (1962). It is assumed that Alaska will increase its percentage so that, in effect, the present level of rates is maintained.

<sup>4</sup> Included in "other" State tax revenues.

<sup>5</sup> Less than \$500,000.

<sup>6</sup> Uses the Federal tax base (adjusted gross income or taxable income), with modifications, in the computation of the State individual income tax. The base-broadening features of the President's tax program may be expected to expand the State income tax base and result in an increase in revenues of \$47,000,000 for these States. This increase, which would be in addition to the gain resulting from the \$10,000,000,000 tax reduction, is not included in the estimates presented here.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, May 7, 1963.

Senator SMATHERS. Senator Bennett.

Senator BENNETT. Mr. Chairman, I am sorry that I could not have been here yesterday. I was out making a speech pointing out the weaknesses of the tax cut proposition.

Secretary DILLON. I regret that.

Senator BENNETT. To some businessmen. So some of the questions I may want to raise today may have already been covered. If they have and you can refer me approximately to your answers, that will enable us to shorten this conversation a little bit.

I heard your statement when it was read on Tuesday, and the questions that I am going to ask come out of my reaction to it largely.

You make the rather common and obvious statement—let's put it this way: You are referring to the President's recommendation and you say:

He also recommended structural revisions that would broaden the tax base.

Some of these structural revisions were rejected, but the policy remains.

Do you believe the tax base should be broadened at this present time or should be restricted?

Secretary DILLON. I think there are two questions involved here.

We believe that inequities that have crept into the tax system, some of which may have been perfectly justified because of the very high rates that were extant and that are extant—should be removed when we bring down the rate structure. That is one point.

The other point was that we felt that it was highly important to get the rates, the top marginal rates in each bracket, down just as low as possible, and we aimed originally at a level of a top rate of 65 percent, as you know, and a bottom rate of 14 percent on the first \$1,000 of income. We did state the main revenue adding suggestion—although you might call it base broadening—was this 5-percent floor. That did not work out.

It would have added about \$2.3 billion to the total of the bill. We stated at that time before the House committee that if this were not accepted, we would then have to change our recommendation on rates, because we could not afford to have as large a tax reduction as would otherwise be the case.

We felt the total tax reduction should be held in the general area of the President's recommendation, which totaled \$10.3 billion. I think it is very interesting that in the area of structural reforms and rate reductions, leaving aside for a moment the capital gain rate reduction which rather distort the picture because, in early years at least they have the effect of increasing revenues because of more rapid turnover, the original recommendations of the President would have led to a reduction, an overall reduction, of \$11,070 million. When we got through with the House bill, the total reduction was \$11,060 million. So it came out almost exactly where the original recommendation was. We made up for the base broadening suggestions that were not accepted either by leaving out certain special reductions which we had recommended or by changing the rate structure.

I think the rate structure is greatly improved. I would have rather have seen it down to a 65-percent top, but I think 70 percent is perfectly adequate and we are happy with that now.

Senator BENNETT. Actually, have you not taken 1½ million taxpayers off the roll and does not that narrow the base?

Secretary DILLON. Oh, I see.

Senator BENNETT. When you talk about broadening the base, you usually talk about getting more taxes from more people.

Secretary DILLON. I see what you mean, Senator, broadening the base in the sense of broadening the number of people on the tax rolls. I do not think we feel any action in that regard is necessary. In fact, we have made a recommendation that would take some of them off.

What has happened is that over the past 20 years, by holding exemptions level, and with the level of income increasing in large part because of inflation, a great number of taxpayers have been added to the rolls, and I would say there are twice as many taxpayers at least now on the rolls as there were 20 years ago. So therefore, a recommendation such as we made, which takes 3 percent of the very lowest income people off the tax rolls, people some of whom are on relief, who do not have enough to get by on, we think that is perfectly proper.

What we are talking about, in broadening the base, is obtaining revenue from areas where we think it should be obtained, which by special dispensations have avoided it. A typical example is the tightening up in the area of personal holding companies.

Senator BENNETT. As I read the bill and have had it explained to me, it seems to me if there is any base broadening it is in the middle incomes where the burden has been increased. We will come to that a little later.

Let me move on to my second question.

You say:

Utilization of plant capacity remains well below preferred operating levels.

The McGraw-Hill study in I think July of this year says the preferred operating level is about 92 percent and that the current operating level is about 87 percent. Is that not a pretty close approximation of operating at satisfactory levels, particularly in the face of the fact that the same McGraw-Hill report says 22 percent of our manufacturing plant capacity is obsolescent and high cost.

So it seems to me that the economy in terms of its use of plant capacity is operating at a reasonably satisfactory level. Would you agree if these figures are accurate?

Secretary DILLON. No; not entirely. I think the figures are presumably accurate. It shows that the capacity that we are operating at is better than it was a year ago when it was, I think, 83 or 84 percent. So to that extent it is better. The preferred operating rate, 92 percent, is not maximum capacity. It is the capacity that business likes to operate at and can operate at the cheapest because it is using the full capacity of what they have.

That is one reason we need a tax reduction of this nature. What is beginning to happen is that we may be getting a little bit out of phase again. You go out of phase one way or another. In industrial capacity there probably was a time 5 or 6 years ago when our capacity was a little too ample. We have in the past year made progress, as you say, and that is satisfactory. It is good. We have made progress toward increasing the utilization of the existing capacity. We have cut unused capacity not quite in half, but very nearly. At the same time we have made no progress whatsoever in reducing unemployment. And so, therefore, we are going to come to a time, if business never increases their capacity, where we would have millions and millions of people unemployed, and business operating at full capacity, which would be totally unsatisfactory.

I think business capacity should begin to expand again. Expansion will help to take care of the needs for employment. Expansion will be stimulated by this sort of a tax reduction program, and I think that is why the business community as a whole is so favorable to it.

Senator BENNETT. I have had some experience operating a manufacturing plant. You must expect that part of it will be shut down for repairs, for renovation, for a variety of reasons. You must realize that your orders come in in a way that you cannot control, so that there is part of your plant that is operating at capacity or overcapacity, and there is another part of your plant that is idle.

Secretary DILLON. That is the reason, I understand, why business on their own, all business, has answered McGraw-Hill and stated that they feel 92 percent is their preferred operating rate, because they know that there always has to be this other 8 percent that is not being used.

Senator BENNETT. That you cannot get at?

Secretary DILLON. That you cannot get at.

Senator BENNETT. That is right.

Secretary DILLON. So 92 percent is really where they want to operate.

Senator BENNETT. We are only 5 points off of the 92 percent, or were in July, so that to me it does not seem reasonable to say it is the fact that we have this tremendous underutilization of plant that is creating the unemployment. Actually, we do not have a tremendous underutilization of plant.

Secretary DILLON. It is underconsumption that is creating the unemployment.

Senator BENNETT. We will come to that again in a minute or two.

Why do you suppose that business investment is not increasing at a sufficient rate?

Secretary DILLON. There are two or three reasons.

One reason has been insufficient demand for their products. Another reason has been the profitability of investment, based on their costs, of which taxes are one, and depreciation rates are part of that. All of these things have not been particularly attractive in the last few years for business investment. The combination of inadequate demand and the not particularly attractive profitability atmosphere, which used to be referred to as the profit squeeze, has been the reason why there has been inadequate investment, inadequate from the point of view of keeping our economy operating at a capacity which will provide employment for those who are ready and willing to work, and who are going to increase in great numbers in the coming few years as the young people who were born right after the war in very great numbers begin to enter the labor force, which is happening right now, this year, next year, and it will hit in great force in 1965 and 1966.

Senator BENNETT. I have been interested in observing that in 1950 the profit of corporations was 8 percent of gross national product. Last year it was down to 4.7. The tax saving that would come to all corporations would have a very minor impact when compared with the loss in profit that has come as a result, in my opinion, of this concept that the way to solve all of our problems is to increase consumption by increasing not depreciation or taxes, but by increasing labor's share of the total gross profit available to be divided. We have pushed that up. We have pushed it up until now it is, as I remember, above

70 percent of the total gross national product goes to salaries and wages, and only 4.7 percent is left to sustain the base of investment from which jobs must be created.

It seems to me that the administration should be concerned about redressing that balance, more concerned about redressing that balance which could have some real effect, than it is about trying to persuade industry to make substantial new investments out of a tax cut.

How much is the total tax saving that would be available to corporations under this bill?

Secretary DILLON. If I may answer your earlier statement first, Senator, my own understanding is that those figures are not correct, and I would like the privilege to insert in the record at a later date the figures as we see them of the increase in labor's take in costs of production.

(The following material was supplied for the record:)

#### RECENT EXPERIENCE IN THE PROFIT WAGE SHARE

A careful examination of the economic data shows no evidence of a decline in the before-tax profit share on corporate business that can be attributed to a rising labor share.

Some changes in the share of wages to GNP have occurred but these are due to the changing size of particular GNP components. The proportion of GNP arising in unincorporated business, where the wage share is low, has declined. The proportion of GNP arising in Government, where the wage share is high, has increased.

To examine the narrow issue of the profit and wage share in corporations it is useful to look at that part of GNP that arises from corporations. Since indirect taxes imposed on this GNP go to neither profit nor wages it will help to subtract these out before examining the division. (The resulting statistic that is used as the denominator in the following ratios is referred to technically as the corporate GNP at factor prices.)

Table 1 gives statistics on two series of profits before taxes; namely, gross profits, i.e., before deducting depreciation and net profits, i.e., after deducting depreciation.

TABLE 1.—*Ratios of several profit measures to the gross product of corporate business, 1923-41, 1946-61*

	Gross profit; before depreciation, before taxes	Profit; after depreciation, before taxes		Gross profit; before depreciation, before taxes	Profit; after depreciation, before taxes
1923.....	25.9	18.1	1941.....	30.9	23.5
1924.....	24.4	16.0	1946.....	24.3	18.6
1925.....	25.9	17.7	1947.....	26.3	20.6
1926.....	29.0	20.8	1948.....	29.5	23.4
1927.....	26.7	17.9	1949.....	29.0	22.1
1928.....	27.6	18.7	1950.....	31.3	24.6
1929.....	28.8	20.0	1951.....	30.9	24.2
1930.....	25.2	14.9	1952.....	28.7	21.5
1931.....	18.1	4.9	1953.....	27.5	19.8
1932.....	9.4	-8.5	1954.....	26.9	18.0
1933.....	8.5	-9.5	1955.....	29.7	20.6
1934.....	17.0	3.7	1956.....	28.0	18.7
1935.....	21.2	9.1	1957.....	27.4	17.7
1936.....	23.9	13.6	1958.....	26.7	16.2
1937.....	23.9	14.7	1959.....	28.6	18.5
1938.....	21.6	11.1	1960.....	27.3	16.8
1939.....	23.4	13.7	1961.....	27.0	16.2
1940.....	28.0	19.1	1962.....	27.6	16.1

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

NOTE.—Based on data published by U.S. Department of Commerce, Survey of Current Business. Profits and the corporate GNP relate to domestic activity only. Profit is after inventory valuation adjustment, i.e., it excludes gains and losses due to changing values of inventory on hand. This exclusion leaves a profit figure related only to current business and is thus comparable to current wages. The depreciation used includes amortization deductions plus deductions for accidental damage to fixed capital items charged to current expense.

Several points should be noted :

(1) The years 1948 to 1951 were exceptional in the sense that the profit share rose above the levels characteristic of the 1920's. This is particularly marked because of the abnormally low depreciation deductions in the latter period, but even on a "before" depreciation basis the profit share was abnormally high, due presumably to the shortage of capital from the low investment from 1930-46.

(2) The profit "after depreciation" is a somewhat arbitrary figure depending on the peculiarities of accounting practice and tax law. Profit "before depreciation" represents the gross flow of funds from which the corporation can pay taxes and dividends and finance replacement, modernization, and expansion.

(3) On both a before and after depreciation basis the profit share since 1952 has been comparable to the level of the 1920's. The labor share has not increased.

(4) Since 1950 the profit share has fallen on both bases. The post-1950 drop has been largest in the after depreciation series, due to the fact that the under-depreciation implicit in the 1950 data has been removed by successive changes in depreciation rules.

(5) The drop since 1950 is most easily explained by saying the 1950 share was abnormally high, since the drop has been a return to the levels of the 1920's.

(6) The profit share tends to be higher in good years, such as 1926 and 1929. This level was approached in 1955 and 1956, but since then years have not been very good. The drop in 1960 can be explained this way. It was comparable to the similar years 1958 and 1924.

[From article "Stability in the Labor Market," Federal Reserve bulletin, November 1962]

The number of workers added to the labor force since 1956 has averaged about 700,000 per year. Over this period the labor force participation rate (proportion of population age 14 or over in the labor force) has been declining, in contrast to the rise earlier in the postwar period. The estimated participation rate this year is 57.5 percent compared with 59.3 percent in 1956.

Among male teenagers and older workers participation rates have declined much more sharply than had been anticipated. In most other age-sex groups, increases in labor force rates have also been smaller, or reductions greater, than had been projected for the period.

The slower labor force growth in recent years reflects a combination of economic, social, and demographic forces. Higher levels of unemployment and fewer job opportunities have been important in limiting growth of the labor force, as is suggested by the decline in the overall participation rate. Another factor is that demands for labor have been strongest in those occupations which require extensive education, and some youths have remained in school longer and thus delayed their entrance into the labor force. Furthermore, with the rapid expansion and liberalization of retirement programs, many older workers may have withdrawn from the labor force earlier than expected.

The Bureau of Labor Statistics recently revised its projections of the labor force to take into account data from the 1960 Census of Population and changes in trends of participation rates by age-sex groups. The labor force is now expected to increase 12.3 million in the 1960's rather than 13.5 million as estimated earlier.

Because the actual 1962 level is below the new projection, an average annual increase of 1.4 million workers over the next 3 years will be necessary if the labor force is to reach the 78.9 million now projected for 1965. Whether it expands this fast will depend in large part on whether the economy provides job opportunities for the growing number of potential workers.

#### LABOR INCOME

The rate of increase in hourly wages has continued to slow in recent years, as the chart shows. Excess industrial capacity and heightened competition in product markets have intensified producer attempts to minimize costs. Meanwhile, easier conditions in labor markets, especially among semi-skilled factory workers, have tended to weaken bargaining positions of the unions. Moreover, pressure for wage increases from rising prices has greatly diminished, and automatic wage gains based on increases in consumer prices have been smaller than in earlier years.

Total wages and salaries in October were about 5 percent higher than a year earlier. Such income has changed little since midyear, however, because of the leveling off in employment and a shorter workweek in manufacturing.



## MANUFACTURING

Manufacturing workers on the average earned \$2.40 per hour in October. This was slightly more than at the beginning of the year and was 2.6 percent above October 1961. Labor contracts negotiated this year tended to provide smaller increases than obtained in earlier contracts; in some instances, contracts did not provide for any increase in wage rates. In addition, fewer workers have received deferred wage increases under long-term contracts than in previous years.

In consequence, in those industries in which contracts have been negotiated this year—such as steel, aluminum, and lumber—wage gains have been less than the average for all factory workers. On the other hand, in the auto, rubber, and fabricated metals industries, where deferred wage increases were negotiated before 1962, increases have been above average.

During the recovery of 1961 weekly earnings rose somewhat more than hourly earnings as the workweek lengthened and overtime and other premium payments increased the amount of take-home pay. In recent months weekly earnings have been relatively stable. In October they were \$96.72, 2.3 percent higher than a year earlier.

Increases in weekly earnings over the past year have been largest in fabricated metals; machinery; transportation equipment; stone, clay, and glass; and food. Smaller than average increases were typical in nondurable goods industries. In primary metals average weekly earnings were smaller than last year because of a shorter workweek and no change in wage rates.

After allowances for price changes, the average annual increase in weekly earnings in manufacturing has been over 2 percent a year since 1960. This is a larger gain in purchasing power than in preceding years when both wage rates and consumer prices were rising more rapidly.

Productivity gains in manufacturing have been somewhat in excess of wage increases. Hence, labor costs per unit of output, including an estimate for changes in fringe benefits, declined in 1961 and 1962 and are probably no higher now than in 1959. These changes in wages and productivity have considerably reduced earlier pressure of labor costs on prices.

Secretary DILLON. As I understand it, labor's share has not increased much at all in the last 10 years.

There has been a decrease in profits of corporations. The main reason for that has been the substantial increase in depreciation, which were brought about first by the reforms of 1954 and expedited by the reforms we were able to accomplish last year. I think the explanation is that depreciation was inadequate in those early years and profits were not really as good as business thought they were. Now they have adequate depreciation, and the profits that they show are real. However, I do not think corporate profits are necessarily adequate, and there has been a great effort on the part of the administration to hold the line and to encourage labor for its part to hold the line on wage increases. The record shows and is clear that in the last 2 or 3 years the increases have remained within the level of the increases in productivity, and for the first time, certainly since the war and maybe in our history, in a period as long as we have had of recovery—now two and a half years, nearly 3 years of recovery—the actual unit costs of labor going into manufacturing have decreased.

I think that helps profitability and I think that it helps us in our ability to compete abroad. I think it shows a responsible attitude on the part of senior labor leaders, and I do think that there is an emphasis by the administration on the need to keep labor wage increases within the general confines of productivity increases equal to the emphasis on keeping price increases within reasonable bounds.

Senator BENNETT. Of course, this is an intangible, but I cannot see the equal emphasis. I think labor has been encouraged to believe that all of the increase in productivity should go to them.

Secretary DILLON. That is not the theory at all of the guideposts that were announced. I am not an economist, but I think that, at a later date, the Chairman of the Council of Economic Advisers, Mr. Heller, will appear, and I believe he would be very glad to explain that in detail. I know that is not his theory, and it is not the administration's theory.

Senator BENNETT. If industry is going to recover any of the share of the gross national product that it has lost in these last 10 years, then labor's share, which is by large the greatest share, roughly now by the figures that I have been using 70 percent, must make some sacrifices or must hold still for a while until the other fellow catches up.

Secretary DILLON. What happens is that in a period of rapid increase, there are increases in productivity as we move to full employment and profits traditionally in those periods increase faster than other areas of the economy and that would lead to that sort of a—

Senator BENNETT. How long has it been that profits have been increased faster than other areas of the economy?

Secretary DILLON. They are doing it right now.

Senator BENNETT. But at a very minor rate.

For the last 10 years profits in industry have tended to move sideways. They have just kept at approximately an even level. They have gone up a little in the last year or so.

Secretary DILLON. That is right, and it is as a result of the policies of the administration to a large extent.

Senator BENNETT. The other thing that concerns me in this present situation, you are counting very heavily on acceptance of the business community of this tax reduction as an incentive. You are counting on the fact that this will be a spur to the confidence of our business leaders, and that therefore they will produce the kind of an atmosphere—

Secretary DILLON. That is what they tell me.

Senator BENNETT. And yet you are going to ask them to wait until 1970 before their share of the tax reduction is fully realized.

Secretary DILLON. No. There we come to the question of cash flow. As far as profitability is concerned, which we have just been discussing, and which I think I fully agree with you, is the key area; they get the benefit of that immediately.

We are suggesting, and there is, in this bill, an acceleration of payments to put tax payments by corporations with annual tax liabilities of over \$100,000 on a fully current basis the same way individual payments have been for some time. There have been two previous accelerations which have moved corporate payments up to about halfway, and this would complete the job. In each of those other two cases, there was no compensating reduction in corporation taxes, and in neither of the cases did it have any effect on business investment.

Indeed, the last one took place right in the middle of the greatest investment boom we have had, the 1956-57 boom. So I think this will have very little effect.

I have admitted that there are, and it is true there are, one or two industries which really are important industries that are in need of

cash. The steel industry is the outstanding example. But when you take industry as a whole, their cash position is very heavy. It has never been as good as it is now.

A greater proportion of their expansion, of their modernization, is being financed every year through internal resources, and that will continue to be the case, because they have been so much increased by the increase in depreciation allowances and the beneficial effects of the investment credit. As a result of these two things, I do not see any problem in a further acceleration of taxes. The cash flow problem is simply not the problem of industry as a whole.

Senator DIRKSEN. Will you yield?

Senator BENNETT. Yes.

Senator DIRKSEN. Mr. Secretary, it would certainly take more than their internal resources and their depreciation allowances to develop the kind of an expansion that you foresee under this bill; is that not correct?

Secretary DILLON. Oh, yes.

I would expect that they would come to the market more in the way they used to do when funds would be relatively available, so that our savings, instead of having to flow abroad to find investments in foreign bonds and one thing and another of that nature, would find a haven here and find useful work here and would help industry to expand.

Last year, the total expansion of industry was just about level with their internal funds, and I think that with the greater expansion, of course, they will use more. They should use more. That would be very healthy.

Senator BENNETT. Before Senator Dirksen continues that, would not the effect of this step-up in collections be directly on cash flow, and is it not the cash flow that you are depending on to provide the increased investment to provide in turn the increased jobs?

Secretary DILLON. No, we are not relying on cash flow to provide increased investment. We are relying on increased profitability, increased incentive to invest. The corporations have plenty of cash, and have adequate access to it in the banks and in the investment banking fraternity. If there is investment that becomes attractive through increased incentives, increased profitability, they will have no difficulty in raising the funds to make that investment.

Senator BENNETT. I do not quite agree with that. This may be true for the large corporations. For the small corporation, his probably is the cash that is generated inside his own business. The small corporation, the medium sized one, is not the one that buys tax anticipation notes. He needs all the cash he can get. And of course this program will slow down or will accelerate as cash flow into taxes, and will present him with some problems.

Secretary DILLON. I agree with you entirely, Senator, that the situation of the small business is quite different, but I think, as you are aware, there is no suggestion that tax payments of small business be accelerated. They will get the full benefit immediately. The acceleration does not take place except on that portion of tax liabilities which is over \$100,000 annually, which means that a corporation has to have earnings of some \$200,000 before it is affected in the slightest. And then it is only affected on the portion of earnings over \$200,000.

So you are getting up into fairly substantial corporations before this will have any real effect. I think that is the reason that Congress,

when they made this last acceleration in the 1954 act, when Congress is wisely decided I think to have a speedup, then that they set that \$100,000 floor. We have just followed the provisions of that act, which was a very essential and integral part of the 1954 code.

Now the real answer to this thing is that we are trying to get funds in here to balance our budget. We have the choice. We either can cut corporation taxes and have this speedup, get a lot of the funds back in a way that will not hurt the big corporations, or, if we object to the speedup, we just will find ourselves in a position where we cannot cut corporate taxes. That is our choice. It is perfectly plain, and I think all the large businesses, when they have that choice given to them, will say, "We prefer to have our taxes cut and our tax payments slightly speeded up."

Senator BENNETT. For the record, is it not true that there will be some of the large businesses which, under this pattern, will actually pay more dollars out in taxes before 1970 than would be the case if they continued at the present rate.

Secretary DILLON. No, sir.

For the record, that is not true.

Senator BENNETT. I have been told that a corporation with a taxable income of \$10 million in 1963 would have a tax liability of \$5,194,500 in 1966, 1967, and 1968. Their payments will be \$5,262,850. That is about \$70,000 increase for those 3 years.

Secretary DILLON. No. I will give you the actual rates on that if you will allow me a moment.

The actual effect on corporations with \$10 million taxable income under the House bill is as follows:

Under the present law they will pay a total, that is before tax reduction, before speedup, they will pay a total of \$5,195,000. Under the House bill they will pay less than that. They will pay, the exact figures are, in 1964 when this first starts, they pay very little less. It is practically identical. It is \$5,192,000.

In 1965 it goes down to \$5,126,000, which is \$70,000 less than in 1963.

In 1966 it is \$5,146,000, which is \$50,000 less than in 1963.

That same figure continues through 1968, and in 1969 it drops to \$5,005,000.

In 1970 it is the same, and they get their complete cash flow benefit in 1971, when it drops to \$4,704,000.

This was worked out with great care, and there is no reason why any corporation should pay any more tax in any year than it would otherwise pay.

Senator BENNETT. Are you not assuming that when they estimate their tax they are only going to pay 75 percent of it?

Secretary DILLON. I am assuming that, and the reason I am assuming that is that we have had now some 6 or 7 or 8 years of experience with this speedup in taxes, semispeedup, and that is the figure that corporations pay. So I can see no reason why they will change their procedures.

Senator BENNETT. But eventually they have to pay the hundred percent; do they not?

Secretary DILLON. They pay that the following year; yes.

Senator BENNETT. Oh, so this is a—

Secretary DILLON. This is a relief provision that was written in 1954 which is very proper and which we have not changed in any way. We are continuing it. It says that a corporation complies if it pays 70 percent of what it should pay under the speedup.

They are allowed this 30 percent margin of error, and most corporations, to be sure to fit in with that, pay about 75 percent. They have found that works. They get in no trouble with the tax authorities, and that is business practice today and has been for the last 5 years. There is no reason for it to change.

We have continued the same provision. So actually for a big company, while there is a speedup to a current basis, there is this provision—because it is difficult to estimate what current taxes are—and we assume for the purposes of the law they are current if they have paid 70 percent of the taxes that would be currently due.

Senator BENNETT. And you come out finally with 30 percent of the taxes unpaid at the end of each calendar year, which add in the next calendar year, and then you spin that out into the next calendar year, and so on out?

Secretary DILLON. Presently corporations pay taxes under this same system, and what will eventually happen will be that they will pay a quarter of their estimate in April, another quarter in June, a quarter in September, a quarter in December. But those four quarters of estimated tax will only have to be 70 percent of the final tax. Then they have the right to adjust, when they find out what their actual expenditures and actual earnings are, because, as you well know, a big corporation does not know on December 15 what its earnings are.

Senator BENNETT. That is right.

Secretary DILLON. They have the right to pay the remainder each year either on March 15 in whole or on March 15 and June 15.

Most of the big corporations presently split this excess amount, and pay half of it on March 15 and half of it on June 15, and I think they will probably continue to do so.

Senator BENNETT. But in that year in which they make four anticipatory payments and two payments based on their past profit, they are going to have to pay the equivalent of 100 percent of their tax?

Secretary DILLON. They will pay a full tax.

Senator BENNETT. Yes.

Secretary DILLON. They always pay a full tax.

Senator BENNETT. When you add that in, do you not get a figure which is higher than the present rate?

Secretary DILLON. No, sir. That is what we figured out very carefully.

I would be glad to give you our table. I am sure it will convince you that they do not, because the figures are perfectly clear.

Senator BENNETT. It will be interesting.

You have got to convince our staff, because these figures came from them. They gave me these figures, that a \$10 million profit at present rates in 1963 would be \$5,194,500; you used \$5,195,000, so it is approximately the same.

In 1966, 1967, and 1968, their payments would be \$5,262,850. And taking a corporation that had a profit of \$12 million, the staff says they would pay larger taxes in 1966, 1967, and 1968.

Secretary DILLON. My only question on that is, these figures that we have given you were also worked out with your staff and they agree with them, so there must be a different assumption, and if they assumed a 75 percent payment—

Senator BENNETT. They assume a 100 percent payment.

Secretary DILLON. Nobody will pay 100 percent.

Senator BENNETT. Oh, no; but the balance remains over, and has the impact on the second year.

Now, if you are keeping all your years separate, then you can get along with this.

Secretary DILLON. I do not wish to prolong the argument. Our table is agreed to by your staff as well as by ours. It is table 2 of exhibit 2 attached to my written statement.

Senator BENNETT. We will see if we can get you together.

Now my colleague from Illinois started to ask a question. I pulled him off. I did not think this discussion would go on so long. I will be happy to yield.

Have I taken you to the point where your question no longer has any current application? If I have, I am sorry.

Senator DIRKSEN. This is a live and worldshaking exchange.

Senator BENNETT. That is good.

In your statement you say that the proposed tax cut should give an impetus to put an end to the pattern of recession. I would like to read what you said:

This is not to say that unless tax reduction is enacted—and enacted soon—recession will necessarily follow. It is only to suggest that without the thrust that significant tax reductions can provide, there is no basis in recent experience to predict or expect that the economy will break out of the disappointing pattern of recent years.

On the other hand, a substantial across-the-board reduction in taxes should give our economy the impetus it needs to put an end to this pattern of recession.

Do you want the committee to understand that if this one tax cut is adopted, we are not going to have any more recessions?

Secretary DILLON. I would like the committee to understand, to make it a little clearer, that if we adopt this tax cut, we will have adopted a fiscal policy which will mean that, while our economy will move up and down, recessions will not be as pronounced and as sharp as they have been in the past. We will be able to approximate more nearly what has happened in Europe in the last 10 years, if not do better—I do not see why the United States cannot do as well as or better than other countries.

The countries of Europe by fiscal policies such as we are now recommending have been able to avoid recessions. They have not had one for 10 years in Germany, in France, in Italy. As I point out later in my written statement, while this is a new experience for the United States, it is only what is happening in other parts of the world and I do not see any reason why we cannot do as well as they.

Senator BENNETT. In 1954 we had a tax cut of about \$7.5 billion. Since then we have had continued deficits. We have had \$26 billion added to our deficit. We have had a recession which produced the greatest single year peacetime deficit.

Now why should this tax cut be any different than that?

Secretary DILLON. The reason, I think is, a very simple one. In 1954 we removed largely the excess profits taxes, excessively high

taxes that were put on to restrain consumption during the Korean war, but we made no attempt to attack the basic wartime tax structure that came into being during World War II, and that we have lived with since. It is the highest direct tax structure of any country in the world with the possible exception of Great Britain.

Now the other countries have found that this sort of a tax structure removes incentives and does not allow business to move forward. Certainly I think that in this regard the National Association of Manufacturers, of which I remember that you were once the president—

Senator BENNETT. I am never allowed to forget it.

Secretary DILLON (continuing). Have taken a position which I think is correct, that the tax load has been too heavy, and that the private economy, with this heavy tax load, has not been able to perform as it should.

I agree with them, and I think that that is the general feeling of business, and I think that this tax reduction will put our economy and our tax rates into a more reasonable level that I think one could call a peacetime tax system that we could live with. I think therefore we will do better.

Senator BENNETT. Is it not true that in the 1954 tax law we made a 10-percent cut in personal rates?

It was not just removing the excess profits tax?

Secretary DILLON. Yes, but those personal rates that were cut were very high, and they had just been put up to this—

Senator BENNETT. They were put up for the Korean war. They were cut back in 1954. Also as part of that package we put in the \$50 exclusion in the tax credit, which this bill eliminates.

Was that not incentive to investment?

Secretary DILLON. Unfortunately, no. It did not work that way.

What it was and the way it worked, and it worked well in this respect, it mitigated the severity of the 91-, 92-, and 89-percent rates.

The benefits of it flowed well over half to high-income taxpayers, and I think it was a way to cut high rates. The Congress apparently at that time did not feel in a position to cut these high tax rates the way we are recommending now so they did it in a roundabout fashion. They put that in.

The record is perfectly clear it did not stimulate investment in equities. Indeed, corporate financial structure today shows a greater percentage in debt than it did in 1954 when this was put in. So it certainly had no effect that way whatsoever.

Senator BENNETT. It certainly stimulated a lot of little people to become stockholders.

Secretary DILLON. That was not the credit. I think one element that did that was the \$50 exclusion, and in recognition of this the House bill has doubled to \$100. But there are plenty of other reasons for that broad increase, including a rise in mutual funds and many plans of corporations to sell stock on attractive terms to their employees, which I think is a very good idea and which we strongly favor.

Senator BENNETT. In your colloquy with Senator Talmadge, you repeated what I think is in your original statement, that you expect as a result of this tax cut and the expected stimulation of business

and consumption that you are going to be able to balance the budget in 1967 or perhaps 1968. That is 5 years ahead.

I just want to make the point—

Secretary DILLON. This is fiscal 1964; 1968 is 4 years.

Senator BENNETT. Four years ahead.

The tax cut of 1956 did not produce any level of balanced budgets, and we have had \$26 billion increase in the deficit since that one went in.

So I wonder if it is fair to assume that a tax cut has that kind of an effect.

Secretary DILLON. Certainly it has been the history that tax cuts from high rates do stimulate the economy, and do stimulate revenues.

I have referred in the past to the history of the 1920's, the statements made by the eminent Secretary of the Treasury Andrew Mellon in his annual reports, where he points out very clearly and succinctly that reductions in tax rates that are too high lead to increased rather than decreased Government revenues, and I would be glad to give you those quotations if you would like to have them.

Senator BENNETT. I know they are there, and I think you also said the other day that Mellon was working against surpluses.

Secretary DILLON. That is correct, at that time.

All I am saying is that tax reduction does stimulate the economy. It certainly is also the result—it is what has happened in Germany, it is what has happened in Austria, it is what has happened in Japan, it is what has happened in all of these other countries, which I say have done a better job than the United States in the last 10 years in keeping their economy fully employed and moving ahead.

Senator BENNETT. Of course, is it not also true that Germany and Japan were workin' up out of the rubble? They had a tremendous backlog to go through, and it is my impression that at the present time some of the problems that we have been facing here in the last few years are beginning to show up in the economy of these foreign countries.

Secretary DILLON. It is certainly true, Senator, I agree with you entirely that they started from there, and that is why I take a shorter period, say from 1955 when their economic recovery was reasonably completed.

But even if you want to take a more modern time, take it in the last 3 years, the last 4 years, this year, next year, their rates of growth are considerably higher than ours and continually so, and one of the reasons they have done it is because they have adopted tax systems and they have made great efforts to use tax systems that would stimulate the economy and allow it to operate freely.

I think it is of a good deal of interest that the present conservative Government in the United Kingdom, after careful study, adopted the exact same policy last spring, substantially reduced their taxes, and the result has been a very sharp stimulation in their economy, and a very sharp reduction in unemployment, which came even quicker than they would have expected. But it is directly traceable to this.

Senator BENNETT. I still am unconvinced.

I think the European situation is completely different from our own. They have had to generate their whole capital structure. They have also been able to undersell us in the world markets, which has accounted



in part for the tremendous rate of increase of their output. They are just now beginning to run into labor difficulties. Their people were content to work at lower wages in order to get this thing started, and with the memory of the terrible depressions they had gone through behind them.

Let me return again. I do not believe you want the committee to think that this tax cut, if adopted, will give the economy the impetus it needs to put an end to the pattern of recession.

Now that means to me no more recessions. This tax cut is the key, either in size or in pattern, and if we do this there will be no more recessions.

Secretary DILLON. I think that I would maintain that statement, but I would qualify it a little differently. I do not mean that there will never be any more recessions or that the economy will never have ups and downs. As it moves ahead, the private economy is bound to do that. That is inherent in its nature.

What I do mean is that the pattern of recessions every 30-odd months that we have had in the last few years, and the steepness of these recessions will be changed. We will break out of that. We will be able to have much longer periods of steady growth, and when our growth does slow up, the slowup will be smaller than would have been the case before.

We have shown perfectly clearly that progress can be made in this regard. The difference between the last 10 years and the prewar period is staggering, and I think we can make further improvement now in the same way as we made that improvement between the types of things that happened in the early days of this century and carried right through to the thirties, and which are no longer a part of our economic pattern because of fiscal policies which we have adopted.

Senator BENNETT. Of course one of the aspects of recession is unemployment.

We are making a tax cut off the top of the business cycle and not at the bottom. Yet our unemployment still continues.

How effective do you think this cut is going to be in terms of numbers, if you would like to take a guess, in reducing our unemployment?

Secretary DILLON. I think that is very difficult.

Senator BENNETT. I recognize that it is.

Secretary DILLON. All I can do is to fall back, I would say, on statements of people who are most concerned. The labor unions, the AFL-CIO, as I read into the record yesterday, indicate that this tax reduction would make a great contribution to reducing the present high levels of unemployment.

Senator BENNETT. In order to reduce our unemployment to 4 percent, we have got to put 1.3 million men back to work before we talk about absorbing those that are coming in every year.

Secretary DILLON. Unfortunately, I think the actual fact is that you would have to put back many more than that, because history shows that, as the economy increases and we become more prosperous, there is a tendency for more people to enter the labor force and seek jobs, people who do not even try to look for jobs now because they know it is hopeless. I doubt that 1.3 million new jobs would bring us down to 4-percent unemployment. I think the job is even bigger than that.

Senator BENNETT. But you do not want the committee to think that

this tax cut is going to provide sufficient incentive so that that can be done within a year or so?

Secretary DILLON. Oh, no.

This will take a period of time. It should be perfectly possible for this to be accomplished in maybe 3 years, something of that nature.

But I do not think that we can rest on this tax bill at all. I am also fully convinced, as is the administration, as I think the great majority of the Congress is, that we need to do a great deal more in trying to attack problems of structural employment directly through vocational training programs, things of that nature which are currently underway and which I think have to be strengthened, and which will operate much more effectively in an economy that is operating somewhat near full employment.

Senator BENNETT. Now to turn to another phase of this, somewhere—and I am sorry that I did not mark it—you indicated that you think this might be—that one of the things that must happen before this can be accomplished is provided expenditures are restrained.

Secretary DILLON. That is quite correct. That is for reaching budget balance.

Senator BENNETT. Yes.

Secretary DILLON. Obviously if you are going to take all the extra funds that will flow through an expanding economy and spend them, and spend more than that, you will not have a budget balance. You have to have expenditure restraint at the same time. That has always been part of the President's program from the beginning of his recommendation for a tax cut.

Senator BENNETT. When you were here on Tuesday, in answer to some questioning you indicated that it is difficult to restrain expenditures because of the defense and space programs, and that these were the chief reasons why they had been rising. I do not know whether somebody, while I was away, raised this question of increased expenditures by this administration outside of defense and space.

Has that been raised?

Secretary DILLON. No, it has not been raised except in the first day when I pointed out that expenditures outside of defense and space in the first 3 years of this administration have increased less than they did in the final 3 years of the preceding administration, and that is based on the budget estimate for 1964. I am sure that expenditures are going to be less than that; so that record will be even more sharply clear.

All I was pointing out was this: I think we can restrain expenditures in defense. We are beginning to this year. But there has been this big buildup, in defense and space, and increases in interest on public debt, that have been responsible for something between 70 and 75 percent of the total increase in expenditures in the last 3 years.

We have said as part of that that the rise in defense expenditures should be in effect over, and that should level out now, and we should not foresee so much of that.

The question of space, certainly that is going to have a big increase this year, because last year there was appropriated for space nearly \$4 billion, and there was expended only \$2.5 billion. So they are just

catching up on the appropriation level. I think there will also be an increase next year, because it seems apparent that the Congress this year is also going to vote another increase in the appropriation for space, which means next year there will be a further increase in expenditures there. But after that, that program should also level out.

It should then be much easier to control overall Government expenditures in the absence of some unusual international incident that throws all calculations out.

Senator BENNETT. I have asked my staff to prepare a table or a schedule showing increases in the nondefense and nonspace sectors of Government since January 1961, and they total \$5,556 million, including \$732 million for increased interest.

Agriculture, \$1,558 million; Commerce, \$752 million; Health, Education, and Welfare, \$671 million.

Now we are in a pattern in which we look at space and defense and say we, well we have to increase these expenses, and they overshadow all others. But actually, the record of this administration is that it is increasing its expenses outside of that field at a rate which makes them a little less than 50 percent of the total.

I would like to offer that for the record.

Secretary DILLON. Yes.

I would like the opportunity to comment on that when we see it and make any comments on the figures that may be in there, submitting figures from the Bureau of the Budget that may clarify some of those figures because certainly our record does not show anything like half the expenditures coming from nondefense and nonspace.

Senator BENNETT. I am talking about increases.

Secretary DILLON. Just for a quick figure, from fiscal years 1962 to 1964, which includes the 3 years 1962, 1963, and 1964, defense, space, and interest will increase something over \$8 billion. All other expenditures will increase about \$2.5 billion.

So they have increased something less than 25 percent of the total, not 50 percent.

(The chart referred to follows:)

*Expenditures by fiscal year*

[In thousands]

	1961	1962	1963	Change, 1961-63	
					Percent
Nondefense international affairs.....	\$2,600	\$2,817	\$2,874	+\$374	+14.9
Agriculture.....	5,173	5,895	6,731	+1,558	+30.1
Natural resources.....	2,006	2,147	2,380	+374	+18.6
Commerce transportation.....	2,573	2,774	3,325	+752	+29.3
Housing and community development.....	320	340	325	-205	-64.0
Health, labor, and welfare.....	4,244	4,524	4,915	+671	+15.8
Education.....	934	1,076	1,361	+427	+45.7
General government.....	1,709	1,875	2,041	+332	+19.4
Interest.....	0,050	0,108	0,782	+732	+8.0
Veterans benefits.....	5,414	5,403	5,545	+131	+2.4
<b>Total.....</b>	<b>33,923</b>	<b>36,479</b>	<b>39,479</b>	<b>+5,556</b>	<b>+16.9</b>
Defense.....	47,494	51,103	53,004	+5,510	+11.6
Space.....	744	1,287	2,400	+1,656	+222.6

(After reviewing the preceding table, the following material was supplied for the record by the Secretary of the Treasury:)

COMMENT PREPARED BY BUREAU OF THE BUDGET

Several comments can be made about Senator Bennett's statistics as related to the current fiscal situation and about the difference between his figures and others that the Treasury has previously cited to the committee.

(1) Senator Bennett's figures are based on the actual administrative budget expenditures for fiscal year 1961 and the estimate of expenditures for fiscal year 1963 which appeared in the budget last January. However, preliminary actual figures for fiscal 1963 are now available and are preferable to the outdated January estimates. Using the actual data, the figures showing increases for defense and space as opposed to all other activities are as follows:

*Increase in administrative budget expenditures*

	Fiscal 1961 to fiscal 1963, actual	
	In millions of dollars	Percent of total increase
Defense and space.....	7,057	63.7
All other functions.....	3,877	35.0
Interfund transactions.....	141	1.3
Total.....	11,075	100.0

It will be seen that the increase for defense and space between 1961 and 1963 represents 64 percent of the total increase during this period, while the increase for all other functions accounts for only 35 percent of the total rise.

If we add to defense and space, the unavoidable interest charges on the public debt, we find that this category accounts for 72 percent of the increase in administrative budget expenditures between 1961 and 1963.

(2) As has been noted previously, the budget submitted by the President last January provided for a reduction from 1963 to 1964 in total expenditures for programs other than defense, space, and interest charges.

As evidence of the President's policy of applying strict tests of urgency to expenditure proposals, the current estimates for fiscal year 1964 indicate that the increase in administrative budget expenditures for defense, space, and interest from fiscal 1961 to fiscal 1964 represents 74 percent of the total increase. Over this period, expenditures for all other purposes combined will rise by \$3.8 billion compared with an increase of \$5 billion over the preceding 3 years. These figures are shown in the attached table.

*Changes in administrative budget expenditures, fiscal years 1958-61 and 1961-64*

[Dollar amounts in million]

	Budget expenditures			Increase (+) or decrease (-)			
	1958 actual	1961 actual	1964 current estimate	1958-61		1961-64	
					Percent		Percent
Defense, space, and interest....	\$52,012	\$57,288	\$69,376	\$5,276	62.0	\$12,088	74.2
All other functions.....	19,023	24,882	28,728	4,059	48.9	3,846	23.6
Allowances:							
Comparability pay adjustment.....			200			200	1.2
Contingencies.....			175			175	1.1
Interfund transactions (-).....	-567	-654	-679	-87	-9	-25	-2
Total, administrative budget expenditures...	71,369	81,515	97,800	10,146	100.0	16,284	100.0

Senator BENNETT. I think these figures are the President's request rather than the action of the Congress?

Secretary DILLON. So are ours.

Senator BENNETT. My figures show an increase of \$5,556 million since the first of 1961, and they are divided among the various agencies.

Another thing that bothers me about this idea of restraining expenses is the story in this morning's Post which in turn is a story written on the basis of your conversation yesterday with Mr. Gore in part. It says—the heading is "Depressed Area Relief Bills Delayed. Passage of Tax Cut by House Blamed."

An economy move engendered by the administration's tax cut program apparently has stalled until next year—

underlining—

until next year.

A House vote on two measures to relieve unemployment. The bill would authorize the Area Redevelopment Administration to make an added \$155 million in loans and grants to depressed areas and would apply \$900 million for the accelerated public works program.

Now, is this the way we are going to restrain expenses, just postpone them until after the tax bill is passed?

Secretary DILLON. A restraint in expenditures, in the first place, does not necessarily mean that there will never be a new program. It means that the overall total of expenditures will be restrained.

There may be decreases in some areas and increases in other areas. I do not know where the reporter got that idea.

I do not for myself base my opinions as to what the Government is going to do on newspaper stories. I find that sometimes they are accurate and sometimes they are not.

What I do say is that there will be the greatest restraint in recommendations of the Executive, and in this bill, which I think is quite proper, the Congress has taken a strong position that they will try and restrain expenditures.

I think that is just as necessary because, after all, not one penny of expenditures can be spent by the Executive that the Congress itself has not appropriated.

Senator BENNETT. This story that the tax bill got through the House on a promise that the ARA bill would not be brought up for a vote has been floating around ever since the tax bill passed the House.

Can you give us any assurance that the administration will see to it that this additional \$455 million for ARA will not be passed next year?

Secretary DILLON. No; I cannot give you any assurance that it will not be passed. It may well be the Congress will decide they want to pass it.

What actually is going on right now is that a committee of the House of Representatives decided that they wanted to hold hearings on this accelerated public works bill to increase the appropriation for that. This is not desired by the administration, has not been suggested by the administration, but the Congress seems to think the program is attractive, at least that committee did, and is having some hearings on it.

Now I do not know what Congress is going to do next year. It will depend on the employment situation; it will depend on the general situation.

Senator BENNETT. When the ARA bill was up in the Senate, the record shows that they have only spent about 25 percent of their present appropriation. They still have something like \$150 million which they can draw on, and now the administration proposes nearly half a billion dollars more be made available.

It seems to me this is a symbol of this question of restraint of expenditures. This is not something Congress has thought up. This is a program of the administration and, as far as I know, has its backing.

It has certainly had its backing—

Secretary DILLON. The area redevelopment program did, because that was aimed at local spots of unemployment, and it was felt that sort of program can be useful.

I do not mean to give any impression that a policy of expenditure restraint is going to mean that there will never be any programs designed to aid particularly depressed areas in this country. I do not think that would be good policy.

But what I do say is that the overall total of expenditures—I am not taking anything except the overall total of expenditures—they will be restrained, with the cooperation of the Congress.

I may say this is probably the first year that the Congress has taken for some time the strong position that it has taken. I think the debate in the House made this clear, that many of the Members there felt that by adopting this tax bill, they were committing themselves to a policy of greater expenditure restraint, considerably greater than they had exercised in the past.

I think that that will be the case, and I am perfectly confident that with the passage of this bill we will have a situation where the President's pledge to exercise expenditure restraint will have full cooperation from the Congress and will be carried out.

Senator BENNETT. Now, Mr. Chairman, I would like to move on to another area briefly.

Do you feel that this tax cut will stimulate the economy more than increased spending, which would have produced a deficit of the same size without a tax cut?

Secretary DILLON. Yes.

My own feeling is that a tax cut is more effective; that is the administration's feeling. That is why we chose this route. We think this is a more effective route.

We wish to give the advantage and give the opportunity to private industry to help eliminate unemployment. We think they can do the job if the shackles of this repressive tax system is removed from them, and we are glad that the House of Representatives concurred, and we hope the Senate will.

Senator BENNETT. By the statement regarding its effect on recessions and the idea that the tax cut will be more effective as a stimulant, what will happen if the economy is not stimulated?

Is the administration putting itself in a "heads I win, tails you lose" position so it can say, "Well, you did not give us enough" if the econ-

omy is not stimulated, "and it is the fault of the private sector for not picking up the ball"?

Secretary DILLON. No; not at all.

We are giving to the private sector the chance that it has always asked for, if I may return once more to the National Association of Manufacturers. They have asked for it for many, many years. We are confident that, with this less repressive tax system which we think will be a fair peacetime system, the economy will operate in a more effective manner. We can have confidence not only because this is a general view of those who operate businesses, or who are labor leaders, or economists throughout the country, but also because this has been the effect in many countries abroad.

So, therefore, there is just no question but what this will be effective.

Senator BENNETT. Because you have returned to the National Association of Manufacturers, just to get the record clear, are they satisfied with this tax bill in all its pattern?

Secretary DILLON. I do not think any organization of that nature is satisfied in all its aspects, but I think they strongly support tax reduction now as they always have. They would probably like the rates slightly different in this bill, but I think they feel that this goes a long way toward what they would like.

Of course, as you well know, their program calls for a tax reduction about twice the size of this. This is only a small first step toward what they would like to see. We felt that their overall program, which is spread out over a longer period of time, was one that it was a little dangerous to take at this time. We do not think we can go that far; so we have adopted a program that goes only about halfway where they would like to go.

But I think that they would think this was a substantial step in the general direction toward which they want to go, and they would favor such a step.

Senator BENNETT. Of course, I assume they will have a witness before us who will point out the differences.

Secretary DILLON. He will point out all the ways this bill can be improved, I am sure.

Senator BENNETT. That is why we have hearings.

There will be a deficit to which this tax cut will add the beginning lease.

Do you believe that it will be possible to finance this deficit outside the banking system?

Secretary DILLON. So far, we have done so, and I think that we can continue to do so to the extent that it is consistent with the development of the economy. The choice of methods of financing the debt have to take into account the overall needs of the economy for credit, and we have tailored our financing efforts in that direction.

Now, what has happened is that, as of now, the commercial banking system has some \$2 or \$3 billion less in Government holdings today than it had in January 1961 when we started our management of the public debt.

Senator BENNETT. You have done that of course by increasing the amount held by private individuals.

Secretary DILLON. Private individuals, pension funds, savings and loan institutions, other institutions that are not commercial banks..

Senator BENNETT. To the extent that the reductions generated by this bill are going to be required to help finance the deficit created by the bill in order to maintain your present policies, the stimulation of the bill will be reduced; is that a fair statement?

Secretary DILLON. I think this is a question which has to be handled very carefully as we move along.

Certainly at present there is an excess of savings that has not been able to find ready employment, so it has been very easy to finance the Government debt at relatively long term.

There is now some \$20 billion of debt over 5 years outstanding more than there was when we first took over this job. Certainly if the economy advances, there comes a great need for credit, as you pointed out there might and as we would expect there should, then that will be less easy to do and we will have to tailor our financing to the situation at the time in conjunction with Federal Reserve monetary policies.

Senator BENNETT. But that is one of the factors or one of the forces that may absorb part of this tax saving, and if it does, to the extent that it does, the stimulation you are counting on will be reduced.

You say, talking about inflation:

Whether inflation occurs depends on the state of the whole economy, not just on the Federal budget. It can be due either to an excess of demand over supply or to a situation where costs of production rise more rapidly than productivity.

I think you and I will agree—well, I will put it another way. You have made the point that we have excess and unused productive facilities, so there is no excess of demand over supply, and in our conversation earlier you indicated that you did not think that the costs of production had risen more rapidly than productivity.

You summarize in your statement:

For the past 5 years neither type of inflation has been present in our economy.

In the past 5 years our price level has risen 5 percent. What caused it if neither of these things did?

Secretary DILLON. In the first place, it depends what you mean when you talk about price level.

The price level which is most indicative of general inflationary conditions is the broad Bureau of Labor Statistics wholesale price level. That has not risen. It is about 100.7 percent now of the 1957-59 average.

There has been an increase in the consumer index.

Senator BENNETT. It is the consumer index that has risen 5 percent in 5 years.

Secretary DILLON. It is a fact of our type of economy where services have taken a much greater position in the economy than they used to that it is inevitable that there will be some increase in consumer price indexes unless the level of wholesale prices actually declines.

We have not had an actual decline. They have stayed level. So therefore, we have had a modest increase in the consumer index.

Those experts who have studied the consumer index also have commonly criticized it from the point of view that it does not take enough account of the improvement, the grading up in individual items that enter into it. It is a very difficult thing. I am not critical of the



people who put it together. It is a very hard job to do. It just does not do it completely. They revise it every so often, every 10 or 15 years, and they try to take account of this sort of thing.

A certain proportion of the 107, which I think is related to the 1957-59 base, the latest level of the Consumer Price Index, undoubtedly represents increased values and better services that should cost more, so that there is, I think, a general feeling that this does not represent inflation in any way.

Certainly it is the best record of any consumer price index of any of the industrialized countries in the last 5 or 6 years, with the sole exception of Canada, which has a similar record to ours.

Senator BENNETT. But every time the consumer index rises 1 percentage point, the purchasing power of the American people drops \$4.5 billion.

Now we are going to give them a tax cut which will put in the first year about \$6 million in their pocket, and we assume this is going to be multiplied. Yet at the present rate we are taking about \$4.5 billion a year away from them.

Secretary DILLON. No, we are not taking anything away from them.

The real measure of what they get is the measure of physical output and physical consumption. It may be the Federal Reserve Index of industrial production is the best index of that, or the deflated figure for the gross national product, which shows how you go ahead.

The fact is that current prices do have a minor upward bias, and that therefore when we say our gross national product increases by  $4\frac{1}{2}$  or 5 percent in a year, actually the amount of goods and services physically that the people have hold of do not increase that fast. They increase 3,  $3\frac{1}{2}$ , or 4 percent or whatever the figure may be, but about 1 percent less than this dollar figure. But nothing is being taken away from anybody. They are just not getting quite as much as these figures would indicate they are getting.

Senator BENNETT. Let's put it this way: In order to get as much as they had last year, they are going to have to have \$4.5 billion more money to spend, if we continue to have a rise of 1 index point a year as we have had over the last 5 years?

Secretary DILLON. Oh, yes.

All personal income this year in the last 12 months is up \$21 billion, so therefore they are \$15 or \$16 billion better off than they were last year, which is quite considerable.

Senator BENNETT. If they are that well off, the \$6 billion then falls into the same relative pattern as the \$4.5 billion of purchasing power that they are losing, and this is my point.

This is one of those things that is going to offset the stimulating effect of a tax cut.

Secretary DILLON. We are now getting into rather abstruse economics. I do not think it will offset that, but for the record I will be glad to submit a brief statement as to why it will not at this point.

(The following material was supplied for the record :)

#### EFFECT OF INFLATION ON STIMULATION TO THE ECONOMY FROM TAX REDUCTION

I should like to make the following points. First, if there were a 1-point rise in the consumer price index, and if this were a true measure of declining purchasing power of the consumer dollar (which I do not accept for reasons ex-

plained below) it would be a 0.93-percent increase in the cost of living. This number is derived by dividing the index' present level of 107 into a 1-point increase. Total consumption spending in 1962 was \$355 billion. If we apply the 0.93-percent factor to \$355 billion, the "loss" would be \$3.3 billion rather than the \$4.5 billion estimate he uses.

But both these estimates miss the mark. As I stated earlier, a 1-point rise in the consumer price index should not be equated with a 0.93-percent increase in the true cost of living. It was recognition of this point which caused the Bureau of Labor Statistics, to drop the term "cost of living index" and call it a consumer price index. In view of the conceptual difficulties of constructing index numbers, such a rise can reasonably be attributed to quality improvements which are reflected by prices. Would consumers, for example, on the whole prefer to travel across the country in a piston aircraft of 5 years ago in preference to a jet of today, even though the jet fare may be slightly higher than its predecessor? Have there not occurred, during the past 5 years, substantial improvements in the quality of medical and dental services, if only because of better (but more costly) equipment and drugs, to say nothing of the increased knowledge of doctors? This last point is particularly pertinent since it is the services sector, which reflects labor earnings increases, which is responsible for the most of the increase in the consumer price index.

The point I wish to make is not to criticize the consumer price index, but to suggest that a slight rise in its level is not ground to assert that a "loss" of consumer purchasing power has occurred. I think people who are knowledgeable about the construction of the consumer price index will agree that a rise of 1 point, or even 1½ points, a year in such an index can well be taken to reflect comparable improvement in the quality of things consumers buy.

Finally, I should like to make another point. In the Joint Economic Committee estimate of the GNP rise of \$40 billion which this tax bill will cause, it was explicitly assumed that the consumer price index will rise by about 1 point a year. I would maintain, however, that the assumed increase in the consumer price index reflects the trend of quality improvement I spoke about earlier, and hence is not a real loss. I want to add further that if an actual price level increase should occur, the money GNP would then be even higher although the gain in real output would be the same.

The error lies in attributing a real loss, in terms of physical goods and services, to inflation. This is not the problem of inflation since there is no such loss. The evil of inflation is that it redistributes real income and wealth between individuals and groups. Inflation makes some people worse off; others, better off. And it does so in a capricious manner. We intend to maintain a stable purchasing power of money in order to prevent such inequity. But in recognizing such a redistribution effect of inflation, we should not treat it as a loss from our total output of goods and services.

Senator BENNETT. I have just one more question in this series, and this again goes to the tables you have on page 12 and page 13 in your statement.

You show a decrease in tax liability for calendar year 1964, a projected decrease in tax liability of \$7.75 billion.

Then you show that you only anticipate budget receipts will be reduced by \$2.190 billion, and then you say:

These estimated reductions in budget receipts are based on calendar year 1963 estimated income levels, and are computed before any account is taken of the stimulating effect on the economy.

Now you have lost about \$5 billion for me somewhere, and I would be grateful if for the record you would reach out and get it.

Secretary DILLON. That is one of the easier questions you have asked me, Senator.

The table on page 12 refers to calendar year tax liabilities, to the calendar year 1964 beginning January 1, and ending on December 31.

The table refers to the fiscal year receipts which began last June 30 and end next June 30.

As a simple example, there is a corporation reduction in liabilities in 1964 of \$1.320 billion, and no corresponding reduction in receipts in the fiscal year 1964, because the funds we get from corporations in fiscal 1964 are based upon their 1963 earnings, not their 1964 earnings.

So it is the difference between calendar and fiscal years, and also in withholding rates. A change in withholding rates, in 1 calendar year would only be in effect for 6 months of the fiscal year, which is the reason that the individual rate is much less. It comes to somewhat less than half of the total.

And, finally, on the question of revenue raising structural reforms, all of them will take effect on January 1, but they will be effective in the taxes which people pay on their 1964 income mostly in 1965. It might be that someone would be smart enough to figure this out in his estimate that he makes, his advance estimate in April of 1964, what that effect would be. But the record of 1954 is that nobody does that. They wait until the end of the year, and they figure out what the fact is. So therefore the structural provisions that show calendar liabilities come in as fiscal year receipts in the following fiscal year 1965.

So that is the reason for the difference between those two figures. It is a relatively simple concept.

Senator BENNETT. You are saying then if this schedule were extended to include the last half of the calendar year 1964 and the first half of the fiscal year 1965, that the total, the two totals would be—

Secretary DILLON. They would be nearer together.

Senator BENNETT. Nearer in balance?

Secretary DILLON. They would be nearer in balance.

Senator BENNETT. Yes.

Secretary DILLON. The calendar year liability of 1964 is \$7.75 billion, and you go over and you see that fiscal year 1965 is \$7.95 billion, somewhat larger, but roughly in balance. The calendar year figure here that we show for 1965 of \$11 billion will largely show up in fiscal year 1966.

Senator BENNETT. Have you worked up a chart or a schedule showing your estimates of the pattern under which this stimulating factor will come into the picture to lead you to a final budget balance in 1967 or 1968?

Secretary DILLON. No; we have not done that.

In some detail, we give the figures here which we have arrived at for fiscal 1964 and fiscal 1965. Thereafter we have not done it in the same detail, but have assumed that the economy will continue to advance at normal rates, that we will not have a recession as a result of the stimulation from this tax reduction, and that there will be restraint on expenditures. I think it is really not of much practical use to try and work that out in detail.

We have the Joint Economic Committee of the Congress, which probably is as competent as anyone else in this field, which did make a study of this and made a report that tax reduction would stimulate gross national product by about \$40 billion when actually effective.

I might give you one figure which would be of interest to you. In the area where we had to make more definite estimates, which is for 1964 and 1965, we have assumed—and we did this early when we were making these assumptions last spring—that if the tax bill went into effect as the House bill provides, there would be a stimulus

to our gross national product during 1964 of \$12.5 billion. Our figures are based on that, that the gross national product be \$12.5 billion higher with the tax cut than it would have been otherwise.

We were rather pleased and pleasantly surprised when we read in the paper the other day the estimate reached at the annual meeting of the National Association of Business Economists, the combined estimate of several hundred leading business economists representing all the major companies of the country. They were asked as an exercise what they felt the effect of the tax cut would be, and their combined judgment was that the tax cut would add \$12 billion to the gross national product in 1964. It is nearly identical with ours, and gives us some strength and confidence in our figures.

Senator BENNETT. Mr. Chairman, I have kept the Secretary past the witching hour of 12, and I have also monopolized the time today. I did not think these questions would run out so long. I still have some more.

I recognize that my colleagues have been sitting here too long.

What is the chairman's wish?

Senator LONG. Well, I thought we would continue along here if the Secretary had no objection, until about 1 o'clock, and then come back about 2 o'clock. I hoped we could dispose of the Secretary's testimony, finish with the Secretary's testimony today.

The Director of the Budget has been waiting to testify. I have been under the impression that it would only be about a half hour of testimony by the Secretary today, because I thought that most Senators had finished their questions.

If the Senator wants to continue, I suggest he go ahead and we will continue to about 1 o'clock if the Secretary is willing to stay that long, and if that would be convenient to the Secretary we could come back about 2 o'clock.

I would hope we could conclude with the Secretary's testimony rather than have to call him back.

Senator BENNETT. The other questions that I have are not directly related. I can make a break.

I would be happy to yield to either of my colleagues on the left from now until 1 o'clock and give the Secretary a little bit of a rest that would come from fencing with another brain than mine, and then let the others of my colleagues start at 2 o'clock and then maybe I will either repent and ask no more questions or condense what I have and I will come back a little after 2 o'clock.

Senator LONG. If the Senator would like, of course he could submit some of those questions and permit the Secretary simply to answer them for the record in connection with his testimony, and ask the ones he thinks are most pressing. Otherwise, he can ask them all.

Senator BENNETT. I certainly have not any number of questions which would continue my questioning anything like the amount of time I have had this morning.

If it is all right with the chairman, I would like to withdraw and let my colleagues here take up now and I will look at my remaining questions over the noon hour and try and either condense them or wipe them out.

Senator CURTIS. I will yield to the minority leader.

I do not know where this idea that the questioning might end in 30 minutes arose. I have not had a chance to question yet this week.

Senator LONG. At the time we concluded yesterday, every Senator who was present had the opportunity to ask the questions that he had in mind. It was understood that the Senator from Utah wanted to ask some questions, and also the Senator from Georgia wanted to ask some questions.

We were under the impression that that would be relatively brief. But of course the Senator is not bound by the impression of the chairman, who was Senator Byrd at that time, the impression that he had about the matter.

I guess we will accommodate the Senators the best way we can.

Senator DIRKSEN. Mr. Chairman, I have—

Senator LONG. No one is trying to hold anybody to any impression we might have had. That was just an impression.

I would hope if it is agreeable with the Secretary of the Treasury that he come back and be available to the committee for a few hours this afternoon.

Secretary DILLON. I would be glad to come.

Senator LONG. We had hoped to hear the Director of the Budget today, and I do not believe that is going to be possible. We will have to call him at a later date, I suppose. But at least we might conclude with the Secretary of the Treasury's testimony. He has some other legislation to testify on in connection with.

In addition, he has some very important responsibilities in his own office.

The Senator from Illinois.

Senator DIRKSEN. Mr. Chairman, some of my questions will no doubt be redundant with questions asked by the others, but there is an item on which you may want to furnish some information for the record. It will relate to Treasury financing at the time this bill becomes effective.

I notice you testified before the Ways and Means Committee that those figures were more applicable to calendar 1962 than to 1963 and beyond. But that I mean this: Refunding and financing and refinancing requirements, what they would be and about when those would come.

What is running in my mind is this: That you will be in the capital market competing with corporate enterprises for funds if the expansion foreseen in this bill is going to do the job that you anticipate.

Now I cannot imagine that from internal resources they would have funds enough for expansion, renovating obsolete plants and equipment or building new plants, providing new equipment in some cases, going in for automated equipment. But what is going to be the impact in the face of a \$9 billion deficit in 1964 and 1965 to do all that financing and still be competitive with private enterprise in the capital market?

Secretary DILLON. I would be glad to furnish for the record the amount of refundings and the schedule in those years.

We have pursued a policy of advance refundings and prerefundings which have cleared out a great deal of the debt over the next 2 or 3 years, so we do not face heavy maturities, so to that extent our job will be considerably simplified.

(The following material was supplied for the record:)

The following table shows the interest-bearing public marketable securities as of October 31, 1963, which fall due in fiscal years 1964 and 1965, excluding regular weekly Treasury bills which are now outstanding in the amount of \$38.7 billion. In addition to the rollover of these weekly bills and the refinancing of the maturities shown in the table, the volume of Treasury financing during the remainder of fiscal years 1964 and 1965 will also include new-money borrowing, parts of any issues shown in the schedule refunded into short-term securities falling due in the period covered, and the possible advance refunding of issues not shown in the schedule. However, the financing volume during the period will exclude any payoffs of maturing obligations.

*Schedule of interest-bearing public marketable securities maturing in fiscal years 1964 and 1965<sup>1</sup> outstanding Oct. 31, 1963*

[In millions of dollars]

Year and month of final maturity	Description of security	Amount of maturities		
		Total	Held by—	
			U.S. Government investment accounts and Federal Reserve banks	All other investors
1963: November..	3½-percent certificate, Nov. 15, 1963-D.....	4,554	3,759	795
	4½-percent note, Nov. 15, 1963-C.....	3,011	362	2,650
1964:				
January.....	3.015-percent bill, Jan. 15, 1964.....	2,496	154	2,342
February.....	3-percent bond, Feb. 15, 1964.....	1,634	112	1,522
	3¼-percent certificate, Feb. 15, 1964-A.....	6,741	3,923	2,818
March.....	3.537-percent tax anticipation bill, Mar. 23, 1964.....	2,001		2,001
April.....	1½-percent note, Apr. 1, 1964-EA.....	457		457
	3.062-percent bill, Apr. 15, 1964.....	2,501	216	2,285
May.....	3¼-percent certificate, May 15, 1964-B.....	4,198	3,287	911
	4¾-percent note, May 15, 1964-A.....	4,400	2,846	1,554
	3¾-percent note, May 15, 1964-D.....	2,016	281	1,736
	Total, fiscal year 1964.....	34,009	14,940	19,071
July.....	3.532-percent bill, July 15, 1964.....	1,998	64	1,934
August.....	5-percent note, Aug. 15, 1964-B.....	2,316	223	2,093
	3¾-percent note, Aug. 15, 1964-E.....	5,019	1,739	3,279
	3.575-percent bill, Aug. 31, 1964.....	1,001	27	974
September.....	3.586-percent bill, Sept. 30, 1964.....	1,001	15	986
October.....	1½-percent note, Oct. 1, 1964-EO.....	490		490
November.....	3¾-percent note, Nov. 15, 1964-F.....	6,398	4,149	2,249
	4½-percent note, Nov. 15, 1964-C.....	4,195	2,331	1,865
1965:				
February.....	2½-percent bond, Feb. 15, 1965.....	4,682	584	4,099
April.....	1½-percent note, Apr. 1, 1965-EA.....	466	15	451
May.....	4½-percent note, May 15, 1965-A.....	2,113	428	1,685
	Total, fiscal year 1965.....	29,679	9,575	20,105

<sup>1</sup> Excluding regular weekly Treasury bills.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis.

Senator DIRKSEN. And then there is one other question on which there may be some figures.

The experience with consumer saving let us say for a 10-year period, how much they actually do lay aside, whether it indicates a pattern, and whether, if there is a tax bill, that pattern would continue and that consumption expenditure would not be the expectations that you have in mind.

Secretary DILLON. We would be glad to give you those figures. They are readily available.

(The following material was supplied for the record:)

The record of consumer expenditures over the past 10 years is as follows:

	Percent of consumer ex- penditures to disposable income (percent)		Percent of consumer ex- penditures to disposable income (percent)
1951.....	92.2	1957.....	92.4
1952.....	92.1	1958.....	92.2
1953.....	92.1	1959.....	93.0
1954.....	92.6	1960.....	94.0
1955.....	93.6	1961.....	93.0
1956.....	92.1	1962.....	93.2

Source: Economic Report of the President, 1963, p. 190.

We consider this as representing a very clear pattern that consumers continue to spend about 92 to 94 percent of their disposable after-tax income. They can be expected to continue to do so. It is of interest that the percentage of expenditures rose rather than declined in 1954 and 1955, the 2 years following the effective date of the 1954 tax reduction bill.

Secretary DILLON. The most recent indication of what might happen is the recent survey by Michigan University, which has I guess the most widely known survey of consumer expectations, and they did ask this question, and the great majority of the respondents said they would spend the funds.

Senator DIRKSEN. Now in your statement you express the conviction that this would improve our situation insofar as the gold imbalance is concerned.

I would like to see some amplification of that, because I have some doubts that through tax bill you are going to improve this situation. It is rather distressing as it stands today, and unless there would be an improvement over and above the figures I have seen, we are running at an annual rate of about \$5.2 billion outflow as I recall.

That may have been bettered somewhat, but I think there ought to be some emphasis on exactly how this is going to affect the gold imbalance.

Secretary DILLON. I will be glad to do that.

The basic reason that we think this is important is that capital flows have assumed a much greater importance in balance of payments than they have in the past because of the more integrated world markets. It is vitally important to increase the attraction of investment here in competition with investment elsewhere.

That is what we are primarily relying on, as well as the modernization of our industry at a more rapid rate, which would help to hold down costs.

I might say on this, which is I think a matter of interest, that there is a unanimous view without exception among the leading financial authorities of Europe who are very much concerned naturally with our balance-of-payments deficit, that the single most important action we can take is to pass this tax bill, and that was made very clear in their various conversations when they were here at the time of the IMF meeting.

It is contained in the rationale of the annual report of the Bank for International Settlements, of which many governors of European central banks are directors. They approved that report.

For that reason, we think this is highly important, but we will be glad to give you a further and a more detailed explanation.

(The following was later received for the record:)

#### EFFECT OF TAX PROGRAM ON U.S. BALANCE OF PAYMENTS

The President's tax programs and related economic policies are aimed at achieving a rise in domestic activity characterized by a sizable expansion of investment in new machinery and equipment, greater inducements for venture capital to introduce and market new products and to utilize more efficient processes, and a fuller utilization at home of our domestic savings potential, with maintenance of the overall price stability of recent years. While it is difficult to estimate these effects in specific quantitative terms, we believe the tax program, by stimulating a more rapid rate of growth, a rising level of employment, and an increase in disposable consumer income will thereby increase the profitability and greatly stimulate the volume of new investment in this country. Such an increase in the profitability of investment will constitute not only a strong magnet for the employment of U.S. savings, but will also tend to attract investment capital from foreign countries. And outflows of capital investment, which have contributed importantly to our balance of payments, should be significantly reduced.

Capital has tended to flow to foreign countries in large volume essentially because investors see more profitable opportunities for employing their funds abroad. At the same time, the flow of foreign capital to the United States has remained relatively small. More buoyant conditions at home will be reflected in higher profits and a vast increase in investment opportunities. Domestic businesses and other investors will find more favorable opportunities for employing their funds here—and foreign investors, who are increasingly free to place their funds abroad, will wish to take advantage of the greater opportunities developing to invest in the United States, helping to close the gap in our capital accounts from that direction.

At the same time, firmer conditions in the domestic credit and money markets will facilitate the task of keeping our shorter term interest rates in reasonable equilibrium with those prevailing in the major foreign markets, and prospects for maintaining the recent reductions in the sizable outflows of short-term capital that have developed in recent years will be vastly improved. Thus, one important effect will be to give the monetary authorities greater freedom to deal with such balance-of-payments contingencies as may develop without impeding the domestic economy.

The kind of dynamic, competitive domestic economy which this tax proposal is designed to achieve is a major prerequisite for achieving, in a manner fully consistent with market processes, the more favorable balance on net capital flows which can clearly play a major role in restoring equilibrium to our international accounts. It is mainly for this reason that the stimulus from the tax program can be a critical factor in the longer run solution to our balance-of-payments problem as well as meeting the needs of the domestic economy.

Secretary DILLON. I would like to say about the current balance of payments, I did mention at a somewhat earlier date that the very preliminary figures for the third quarter, as you suggested, Senator, do show an improvement, but the improvement is quite substantial, and the rate of deficit is well under half of the figure that you mentioned earlier for the second quarter.

Senator DIRKSEN. You can supply that for the record?

Secretary DILLON. Yes, I will be glad to.



(The following material was submitted for the record.)

U.S. BALANCE-OF-PAYMENTS DATA

On the basis of preliminary reports from the banking system, from the Department of Commerce, and from Treasury records, our balance-of-payments accounts showed marked improvement in the third quarter compared with the second quarter.

[Seasonally adjusted, in millions of dollars]

	Absolute deficit		Annual rate of deficit	
	3d quarter <sup>1</sup>	2d quarter	3d quarter <sup>1</sup>	2d quarter
Overall deficit, including receipts from sales of non-marketable, convertible, medium-term Government securities.....	-100	-1,110	-400	-4,440
Overall deficit, excluding above receipts.....	-250	-1,262	-1,000	-5,048
Deficit on "regular" transactions, excluding all special Government receipts.....	-450	-1,281	-1,800	-5,124

<sup>1</sup> Based on preliminary data.

Senator CURTIS. Mr. Chairman, I yield to the Senator from Utah. Senator BENNET. We have been trying to get the batting order lined up here.

I just have two or three more questions which are not so philosophically argumentative.

In your statement, referring to the elimination of the deduction on gasoline taxes, license fees, et cetera, you say:

These will have a minor impact on the average taxpayer because the burden is widely dispersed.

Yet you make a strong argument for the bill on the basis that it relieves the individuals and families in the lowest income levels.

Actually, this elimination of State tax deductions is going to affect these people at the lower income levels probably more or as much as any item in the bill.

To use the word that our friend Senator Douglas likes to use, they are regressive therefore.

Do you think this is a sound pattern to give it with one hand and take it away with the other?

Secretary DILLON. No, I disagree with the fact that this is regressive in the slightest. I do not think it has that effect.

I would like to submit for the record a table which shows how this would take effect. This information for all of the changes is contained in table 3 at the end of my written statement, but it may be helpful if I submit an additional table showing that as a percent of present taxes, the amount that would be retained is almost identical, running from the \$3,000 level right up through the top.

These expenditures are not in greater proportion of present tax for lower income people than they are for higher income people. That is a fallacy if people think that.

The fact of the matter is that we have a fiscal problem here where we can reduce taxes by so much. If we do not accept this suggestion

and disallow these miscellaneous taxes, it will just simply mean that we will have to reduce the rate cuts, by an equivalent amount. And since today we are in an automobile economy, where practically every family has an automobile, there will be no perceptible difference whatsoever, because it will be necessary to make these changes in tax rates in the same brackets where we get these funds, unless you are suggesting that we make the tax system much more steeply progressive than it is already, and I think it is probably progressive enough.

I doubt if that is what you are suggesting.

Senator BENNETT. You are actually increasing the progressivity at the lowest end because you now have one rate, and after the bill passes, if it does you will have four.

Secretary DILLON. As far as people in the first \$2,000, that is correct.

But all I am saying is that this disallowance of deductions for miscellaneous taxes is not a regressive change. This would be, if there was no tax reduction associated with it. Certainly you could say any sales tax is that.

But when you have a tax reduction that offsets it, all we are doing is adopting a simpler, more easily administered tax, and a fairer tax. Many of these taxes are not deductible in one place and deductible in another. If deductible, many people do not remember to deduct them, even gasoline taxes. They do not keep the records.

There is an awful lot of argument and disagreeable differences between revenue agents and taxpayers over this sort of deduction, because there is no clear way to figure it. All that would be eliminated, and the taxpayer would be just as well off, because the extra amount that he would have to pay here he will get back in rate reductions.

That is all we are doing. We think it is a great simplification and improvement.

Senator BENNETT. I think it is a simplification, but it will have an effect on the people in the low end much greater than the people in the middle and upper end.

Secretary DILLON. No, no. That is why I would like to introduce this into the record, which shows that the adjusted gross income classes from zero to \$3,000, the revenue effect of disallowing deductions for these taxes as a percentage of present tax is seven-tenths of 1 percent. That increases to 1.2 percent in the \$3,000 to \$5,000 level, and stays there in effect all the way up the scale. It is the same at \$5,000 to \$10,000, it is a little less from \$10,000 to \$20,000, and at \$50,000 and over it gets back to the 1.2 percent.

So it is the same percentage of taxes.

Of course, the greatest amount of revenue comes from the area between \$5,000 and \$10,000, because that is where the greatest amount of our tax revenue is now, about half of it comes out of that area. So anything you do affects that.

Senator BENNETT. I do not want to prolong this.

I drive one automobile. I do not drive it very far. I am in the middle-income area, and it seems to me that the impact of the gas tax and the license tax is the same on me with my one automobile as it is with the man who has a \$1,500 or \$2,000 income or a \$2,500 income who has one automobile and drives it the same number of miles I do.

Secretary DILLON. I think that is correct, but I would imagine that the reason for these figures is that you are probably not the average taxpayer for your income level.

Probably the average one has two cars and drives a good deal more.  
(Table follows:)

*Change in tax liability for individuals resulting from disallowance of deduction for certain State and local taxes*

Adjusted gross income class in thousands of dollars	Change in tax in millions of dollars	Change as a percent of present tax
0 to 3.....	10	0.7
3 to 5.....	50	1.2
5 to 10.....	220	1.2
10 to 20.....	130	1.0
20 to 50.....	60	.9
50 and over.....	50	1.2
Total.....	520	1.1

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Senator BENNETT. You have got to pile a lot of cars into the garage of a man with a \$50,000 income if you are saying that his cost is the same as the man with a \$5,000 income, his percentage is.

Secretary DILLON. All we can do is take the figures off the statistics of income, and there they are. That is what is filed on tax returns.

Maybe these people had better lawyers and more of them file it. Maybe those who are lower forget to file it.

Senator BENNETT. I think that is the answer, that the man whose taxes are withheld and has the standard deduction, he does not fool around with anything else, or he includes this in his standard deduction.

Secretary DILLON. With the standard deduction, of course it does not affect him at all.

Senator BENNETT. That is right.

In your statement you refer to what you consider to be the weaknesses of the recommittal motion made by Mr. Byrnes in the House, which raises the question that is one of the chief ones that concerns this committee.

As we work, should we rush to pass the tax bill before January 1, or should we take our normal pace, even if it means that the tax bill is not passed until after we have the President's budget before us and can see whether he really means restraint?

Is the date so very important?

Secretary DILLON. The date is important from the point of view of economics. It is very important, because we are coming to a point where there is every reason to believe that, without this stimulus, the economy will begin to move toward a plateau or into a recession. If you wait until later it simply means that, even though made retroactive, the stimulus to the economy which will come when the withholding rate is reduced will be delayed by several months, and if you wait until next year, it will not be able to take effect until April or May.

Another reason is, as it has been pointed out by some businessmen, this is the time of year that businesses customarily make their plans

for investment, for modernization, for their programs for the coming year. If they are left in a state of uncertainty, it is likely that their programs will be uncertain and will be smaller. This whole matter is cumulative. That is one of the reasons why business opinion in particular is so strongly in favor of enactment of the tax bill this year, rather than in postponing it.

Senator BENNETT. Do you think the thing is so delicately balanced that the difference of a month is going to, or 60 days—

Secretary DILLON. A difference of 3 months—because Congress does not usually start very rapidly when they come back in January, based on past experience—I think that that will make a real difference. Therefore, from the economic point of view, I think that is important.

Now the other question is why the committee feels that it puts so much emphasis on what the President's budget may be. He has stated there will be a deficit of less than he is now estimating for this year. He is bound to that. You can count on that. Beyond that, if his budget is too high, the Congress always has the opportunity, as they have done very effectively this year, to reduce appropriations.

The latest estimate of Mr. Cannon is that they are going to reduce appropriations some \$5.4 billion, so I do not see any reason for making the American economy wait for a tax bill longer than is necessary.

I am not asking for any unusual procedures, but I think if we adopt the usual procedures and move with relative rapidity following those procedures, we still can pass a bill this year. If the objective is to make the procedures drag out so long that we purposely do not have a tax bill, so we can wait and see the President's message in January, I think that is unnecessary.

Senator BENNETT. I have a copy of a letter written by a Member of the Senate to the chairman. He is not here, but I assume, since copies were sent to all other members of the committee, there would be no objection to reading this much of it in the record:

The underlying premise of the proponents is that the tax cut, if it is to have the desired impact on the economy, must take effect January 1. Certainly the relationship of the tax proposals to the current state of the economy is the central issue in the tax debate. Delay of floor consideration beyond January 1 may make this central issue moot.

In other words, if we do not get it by January 1, why have it at all? That is the implication of that phrase.

You do not agree with that, do you?

Secretary DILLON. I certainly do not.

Senator BENNETT. That is all, Mr. Chairman.

Thank you.

Senator LONG. Senator Curtis.

Senator BENNETT. May I just thank my friend, the Secretary, for his patience.

Secretary DILLON. I thank my friend, the Senator, for a very interesting interrogation.

Senator CURTIS. Mr. Secretary, I am sorry that you had to work so long and so many days. There are a few questions I would like to ask.

The reason this tax bill is expected to have a wholesome effect on our economy is that it will permit business to retain more of their

profits and will also release to individuals a great amount of money to spend; is that correct?

Secretary DILLON. That is one reason.

The other reason, which I think is highly important, is it will increase incentives, it will increase profitability, it will increase incentives to individuals to take risks to invest, because tax rates will be lower, and it will increase business incentives to invest for the same reason.

Senator CURTIS. Now, quite a portion of the Government's spending is outside the regular budget. It is from trust funds, and trust funds are obtained by taxes placed in a separate pocket of the Government.

Do you regard trust fund taxes as having a similar effect upon the economy as other taxes?

Secretary DILLON. Yes.

In the presentation of the budget this year, we tried to give greater emphasis to the cash budget which includes the entire intake and outgo, which includes the trust funds.

The chamber of commerce of the United States made a study of budget practices last year and came out with a strong recommendation that that was a better and more accurate presentation of the actual situation. So we do look on that as the key figure.

Actually, of course, under that system our deficit last year was less than the \$6.2 billion that is shown. I think it is something like \$4.1 billion.

Senator CURTIS. If, over a given period of time, social security taxes increase 1 percent, it means that the burden of doing business insofar as the employer is concerned has increased, and also from the standpoint of the employee, that he has a lesser amount of take-home pay.

Secretary DILLON. That is correct.

Senator CURTIS. Now, do you anticipate that if the President's program is carried out as requested and as set forth, expenditures under trust funds will increase or decrease in the next 4 or 5 years?

Secretary DILLON. Expenditures under the trust funds are increasing steadily and automatically because of social security increases, because more people pass the age of 65 and become eligible for social security.

Senator CURTIS. They become eligible for higher benefits?

Secretary DILLON. And for higher benefits, too.

So I think that trend in the trust funds will continue.

The highway trust fund I think runs about level. That is not the case with unemployment trust funds. It depends largely on the status of unemployment. So I would think that might decrease if we have good business.

Senator CURTIS. Now you recognize the fact that there is a lag between an authorization bill that Congress enacts for any program and the actual outflow of money from the Treasury?

Secretary DILLON. Oh, yes. That is what I have been trying to emphasize in my comments on expenditure control, how you can have expenditure control, which we are having now, by holding down the appropriations, but nevertheless, because of that lag, because of what we did in the past, the actual outflow of funds is still rising.

Senator CURTIS. So the increase in trust fund expenditures relating to social security is not limited only to more people becoming 65 and

living longer and having a higher wage base, but it is also affected by additions to the program; is that not right?

Secretary DILLON. You mean changes in social security programming?

Senator CURTIS. Yes.

Secretary DILLON. From time to time Congress has changed the social security program.

Senator CURTIS. My question was based upon the program of the administration, which includes many, many new features. Some of them have been enacted and some of them have not. Some of them relate to lengthening the period of payments to dependent children, some of them relate to widows' benefits, to many things.

Also, the administration has not abandoned the medicare request have they?

Secretary DILLON. Oh, no. I think the administration feels that that is a good program. It is merely a better way to finance something that has to be financed, than to try and finance it through the approach that is presently in the law, which requires appropriations every year, I mean the Kerr-Mills bill.

Senator CURTIS. Yes. If the President's request for medicare legislation goes through, it will amount to about \$1 billion the first year, will it not?

Secretary DILLON. I am not aware of what the exact figure would be. If you say it is \$1 billion, I would be glad to accept your statement.

I do know that we in the Treasury have studied this. From purely a Treasury point of view, not from the point of view of the American Medical Association, it seems clear to us that the medicare program that would be financed through social security, will result in less cost to the Government and a sounder financial system for the Government.

Now that is not the only reason to enact or not to enact it.

Senator CURTIS. I am not arguing the merits of the proposal.

Secretary DILLON. Neither am I.

Senator CURTIS. My point is that trust fund expenditures in the next 4 or 5 years, if the President's program is carried out, are going to increase substantially; is that not correct?

Secretary DILLON. I think they are going to increase even without the President's program. But if the medicare program is enacted, they will increase, and there will also be a decrease in ordinary budget expenditures that are voted now for matching appropriations under the Kerr-Mills Act, so there would be an offset there.

Senator CURTIS. I will not take time to go into that, but I seriously doubt that. I seriously doubt that.

The so-called King-Anderson bill related to hospitalization for only a limited period for everybody, including the well-to-do and the wealthy. It did not touch the medical needs of the needy and the near needy for prescriptions, for glasses, for things to keep them out of the hospital and all of that, so I would be very, very surprised if it would increase Kerr-Mills expenditures.

Now if the President's program is carried out, will expenditures for education increase in the next 4 or 5 years?

Secretary DILLON. Yes.

I think that there already have been bills passed in this session of Congress allowing for an increase in scholarships for medical students in particular where there are not enough. I think you are debating now a bill which will allow contributions for the construction of certain college buildings that are necessary.

Senator CURTIS. All of that is part of the President's program, is it not?

Secretary DILLON. Yes; that is part of the program.

Senator CURTIS. And is not also general Federal aid to education part of the program?

Secretary DILLON. Oh, yes; that is part of the program.

Senator CURTIS. So if the President's program is carried through, expenditures for education are going to greatly increase.

Secretary DILLON. Federal expenditures for education?

Senator CURTIS. Yes.

Secretary DILLON. Yes.

Senator CURTIS. Now something was said about area redevelopment. If the President's request for legislation prevails and if this program is carried through, isn't that program not going to cause a marked increase in expenditures?

Secretary DILLON. There is an interrelation between the tax bill and such programs as area redevelopment and accelerated public works. If and when the acceleration to the economy becomes effective that the tax bill will give, it will reduce the need for specialized laws trying to mitigate excessive unemployment in certain areas, which led last year to the enactment of the accelerated public works bill.

So I would certainly think that a productive economy which we will get under the tax bill would mean that the expenditures for public works, for area redevelopment, for things of that nature in the next few years would be far less than they would be in the absence of the enactment of the tax bill. That does not mean there would not be any expenditures to that, but they will be far greater if we do not enact the tax bill, because that has been the history in the past. It was the history in 1958 and 1959, and it will be the history again.

Senator CURTIS. That is not quite my question.

If the existing requests of the administration are carried out, we will be spending more in the next 3, 4, or 5 years for area redevelopment than we are spending now; is that not right?

Secretary DILLON. I would think so; yes.

Senator CURTIS. Now if the existing requests—

Secretary DILLON. I do not know whether it would be 3, 4, or 5 years. The next 2 or 3 years; yes.

Senator CURTIS. If existing requests and announced programs for public works are carried out, we are going to spend more money for public works than we are now, is that not true?

Secretary DILLON. I am not aware of that; no. I would rather defer to the Bureau of the Budget, the Director of the Budget on that. I do not know of any administration program to increase expenditures for public works.

Senator CURTIS. Now take a program such as the military retirement, including the Reserves. Are we going to be spending more for that in the future than we are now?

Secretary DILLON. As I understand, the bill that Congress passed unanimously—maybe there were a few votes against it somewhere along

the line—did increase the retirement allowance for the military, and so, therefore, that will increase and also I think there probably are more military people because we have had a larger Army, a larger armed force that are now reaching retirement age. So it is natural that those will increase, as part of the growth of our country.

Senator CURTIS. Separate and apart from the recent pay increase, I think the facts are that the military retirement will increase several-fold.

Secretary DILLON. I think with a larger Army, larger Armed Forces, more of these people are reaching retirement than was the case in the past.

Senator CURTIS. That is the situation where the reaching of the maximum expenditures has a much longer waiting period. It is quite a delayed reaction.

Secretary DILLON. I think that is correct.

Senator CURTIS. Because the people have to earn their retirement before the money is allowed?

Secretary DILLON. I think that is correct; yes, sir.

Senator CURTIS. I think you will find those expenditures running many billion dollars more than they are currently, even disregarding this pay act.

Now, do you anticipate that the Government will spend more for salaries in the future than it is currently?

Secretary DILLON. I would certainly think it would not be spending less.

The Congress has adopted a very fair and just law for Government employees, which provides increases on the theory that their salaries should be kept on equality with salaries paid in industry, with a lag of a year or two. That is not yet fully in effect; so certainly salaries are going to increase until we reach that level, and then it will depend on the speed at which industrial salaries increase, and since they have been averaging maybe 2½- or 3-percent increase over the last couple of years, under this principle, and quite properly, Federal salaries would also increase.

But I think every effort will be made to save personnel and to use methods that are more efficient. As I pointed out earlier, despite 1 year's growth in population, which is substantial, we are now carrying on all the civilian activities of the Government with the same number of employees we had last year. So I think there will be a great effort to do that, to hold down costs that way. So you have these separate tendencies.

Senator CURTIS. There was one pay raise enacted a year or so ago that has not gone into effect yet; is that right?

Secretary DILLON. That is right. It goes into effect on the 1st of January.

Senator CURTIS. And there is a further request from the administration for a pay raise; is that not right?

Secretary DILLON. There is a further request to carry out the directive of Congress, which is that Government employees should have salaries adjusted from time to time to keep them level with industry. And the report from the Bureau of Labor Statistics, which came after very careful work last spring, showed that a year earlier the general level in industry I think was something like 3 or 4 percent above even the new levels that are going to be in effect.



Government pay has generally stayed behind industrial pay, and there is a request in accordance with that law, which is part of the law of the land, for a 4-percent increase which would bring Government employees up to the level of industrial employees where it was a couple of years ago.

Senator CURTIS. Now there are about two dozen new programs that have already been enacted out of the great number requested by the administration. They include the Youth Conservation Corps, the Area Redevelopment, and some of them have been mentioned here. Take the Youth Conservation Corps.

Secretary DILLON. I did not know that had been enacted. Has it?

Senator CURTIS. I think it has.

Secretary DILLON. I do not think so.

Senator CURTIS. I may be wrong on that. It may still be in conference.

I think both bodies have acted on it. But do you anticipate that if the President's program is carried out in that regard, it will cost more money than at present?

Secretary DILLON. Undoubtedly there will be new programs that will cost more money. There will be old programs that will be phased out and savings will be made.

Senator CURTIS. Which ones are going to be phased out?

Secretary DILLON. I will refer you to the Bureau of the Budget for that answer. I wanted the Director of the Budget who is fully prepared to discuss that with the committee.

Senator CURTIS. I think one of the things which is disturbing the country is the President's assurance that expenditures would be held or reduced, or at least held, and there has been no withdrawal of requests for new programs. There has been no request from the administration to hold up the augmenting of those new programs already adopted, and there has been—and I do not know that there can be—there has been no suggestion made concerning nullifying built-in increases that already exist in the law.

As I say, I do not know that it can be done. But they exist all over.

The problem that is facing the people of the country is they are convinced that there is a program of increased spending and tax cutting advocated at the same time. Now if that is not true, then I think they would be greatly assured if some definite statements could be made, not in generalities, that it was going to be done. They should be told what requests for programs would be abandoned and what present programs, whether they are providing a service or not, would be discontinued, and of the new programs that have not gotten their money yet, how many the President would not implement.

Secretary DILLON. That obviously has to come from year to year as situations change.

The basic element that is a fact is, as the President has repeated time and time again, that he will devote a substantial part of the increased revenues that will flow from the stimulation of the economy given by a tax cut to reducing the deficit, and that he will not spend those increased revenues on new programs or old programs or any other kind of programs unless of course the Congress decides otherwise and overrules him. But his recommendation is, he will not do that.

That does not mean, and he has also made it very clear that that does not mean that there will be no new programs. Of course there will be new programs, but there will also be other programs that will be phased down and phased out. The detail of that, as I say, is not within my particular competence. The general policy is.

The Director of the Budget is much more competent and I am sure is perfectly prepared to answer you on that subject in greater detail.

Senator CURTIS. I know the general claim is made, but I also know that no pressure is being applied on Congress to reduce expenditures.

I do know that there is considerable pressure applied to Congress to increase expenditures, from the administration.

Secretary DILLON. I would like to briefly comment on that.

The day before the tax bill went through the House, the administration used all its efforts to oppose two programs. One was a program regarding the railroad retirement fund that, through a technical adjustment of the interest rate paid on that fund, made an unnecessary expenditure of \$25 million this year.

The other was the veterans hospital program. The administration had requested \$12 million in this. The committee had reported \$42 million. This was passed by the House by unanimous consent without any objection from anyone. Everybody was for it. They were very nice. They were very proper. They read into the record objections of the administration, and then proceeded to pass these bills, and the Senate followed suit and passed the bill on the Railroad Retirement Act.

Senator CURTIS. By unanimous consent?

Secretary DILLON. By voice vote, with a minor debate that took them about 20 minutes I think.

So there are cases. The President signed this bill with great reluctance and so indicated when he signed it, but there were some good factors in it.

Senator CURTIS. I am delighted to hear about that.

If they were passed by unanimous consent, the administration leader in the House is permitted to make an objection.

Secretary DILLON. He could have, as well as the minority leader.

Senator CURTIS. Oh, yes.

Secretary DILLON. But he did not choose to.

Senator CURTIS. Yes, and the President did not choose to veto.

Secretary DILLON. No. The veterans bill has not yet reached him; has not passed the Senate.

Certainly if it does, I for one would recommend a veto. But the other bill did rectify a situation in the railroad trust fund that was being invested at inadequate rates and carried out a recommendation of the Treasury to improve that, to make the fund sound. But it went beyond that and authorized an unnecessary expenditure in the next fiscal year of about \$25 million.

Senator CURTIS. What does money cost, about three and a third?

Secretary DILLON. About 3.35 percent.

Senator LONG. The hour of 1 o'clock having arrived, if the Senator has no objection, we will suspend and come back at 2 o'clock.

The Secretary I am sure needs something to sustain him.

Senator CURTIS. I was not through.

Senator LONG. You will be recognized as soon as we come back at 2 o'clock, Senator Curtis.

We will continue as we were going at 2 o'clock.

(Whereupon, at 1:05 p.m., the committee recessed, to reconvene at 2 p.m., the same day.)

AFTERNOON SESSION

Senator SMATHERS. The meeting will come to order.

The Chair recognizes the Senator from Nebraska.

Senator CURTIS. What is the present position of the Treasury now in regard to any change in capital gains rates?

**STATEMENT OF HON. C. DOUGLAS DILLON, SECRETARY OF THE  
TREASURY—Resumed**

Secretary DILLON. We have recommended that the provision in the House bill changing capital gain rates be eliminated, and that they be maintained just as they are now.

Senator CURTIS. Your original proposal advocated changes in capital gains rates; did it not?

Secretary DILLON. Yes; it advocated a rather broad change in capital gains rates, a simplification which would involve the abandonment of the alternative system of computing capital gains, and also involved as an integral part of this a taxation of transfers of assets at death.

Senator CURTIS. Now, that original proposal in reference to imposing a tax at death, what that amounted to was the capital gains tax would be collected for the appreciation in value over the decedent's base and the value at the time of his death or within 1 year.

Secretary DILLON. No; there were various provisions of spreading out the dates of paying the tax.

Senator CURTIS. No; I don't mean paying the tax, but you can take the value on the date of death or 1 year later.

Secretary DILLON. I think so, yes.

Senator CURTIS. But at any rate under existing law if an asset descends according to law or by will, a capital gains is not collected.

Secretary DILLON. No; there is no capital gains collected. The basis of the asset is stepped up. The asset receives a new basis in the hands of the heirs.

In our earlier discussions in the Ways and Means Committee, they very quickly decided they did not want to tax capital gains at death, but they did give serious consideration and did approve in principle a system whereby there would not be a step-up in basis, but the heir would carry over the same basis, and pay a capital gains tax whenever he disposes of the property.

Senator CURTIS. In other words, the present law.

Secretary DILLON. No. The present law allows a step-up in the basis.

Senator CURTIS. The House bill—

Secretary DILLON. The House bill is just present law, but they had in their bill up until right at the last minute a provision which would have prohibited that step-up in basis, and provided—

Senator CURTIS. I was referring to the bill that came over from the House. It contains—

Secretary DILLON. It contains nothing, the present law on that; that is right.

Senator CURTIS. And you at this time are not advocating, you are not going back to your original proposal, but rather suggesting that the reduction in capital gains rates carried in the House bill be deleted.

Secretary DILLON. Yes, because that seems simpler. The other one was more controversial and the House felt it required further study and maybe should be studied in connection with the estate tax.

Senator CURTIS. Is it the plan of the Treasury to submit their original proposal at a later date?

Secretary DILLON. There is no such plan now. I don't know what would happen later when some other Secretary of the Treasury comes along.

Senator CURTIS. Now on another subject, if a company finds that under the definition of a personal holding company in this bill now before us, that they are a personal holding company, and they discover that of course for the first time, are they allowed to liquidate without paying the capital gains on the appreciation of their assets?

Secretary DILLON. There are a number of special provisions that were inserted to allow these companies to liquidate over a period of time, and to take care of all possible hardships that were brought to our attention and to the attention of the committee.

The basic provision is that they could liquidate and pay a capital gains tax on liquidation on accumulated actual earnings and profits which would be the same as if they liquidated now, but any appreciation that was unrealized, any assets they had that had gone up in value, they would carry over that basis and not have to pay any capital gains tax on that. They could liquidate tax free and just carry over that basis.

Senator CURTIS. Now can any other corporation liquidate and receive those advantages?

Secretary DILLON. No; I think that the other corporations, if they liquidate completely, have to pay capital gains tax on the gain attributable both to earnings and profits and unrealized appreciation or can defer tax as unrealized appreciation and pay tax as a dividend on earnings and profits.

The reason for this provision in the House law was that certain companies had been operating perfectly openly under the law as it now is, and would suddenly find themselves personal holding companies, and they thought it was fair to allow them to have an opportunity to liquidate without the penalties that would otherwise apply.

Senator CURTIS. Was that provision put in to meet any special cases?

Secretary DILLON. There were a number. There are a whole series of cases that were brought to our attention that would have a problem here. There were two or three particular ones that we—not we, that the committee and the committee staff—talked with for a long time.

This is, I want to point out, a temporary privilege. They can only take advantage of it for 2 years. If they then don't liquidate, then they go back to present law as to liquidation. So it is designed to

encourage liquidation and getting rid of this personal holding company structure.

Senator CURTIS. Now in regard to the provision in there requiring an artificial computing of interest on installment purchases, is that supported by the Treasury?

Secretary DILLON. Oh, yes; that was one of our original suggestions.

Senator CURTIS. Do you think it will produce a significant amount of revenue?

Secretary DILLON. I think our revenue estimate is very small, probably \$2 million, something like that.

Senator CURTIS. It will cause some difficulty on the part of the taxpayers in computing; will it not?

Secretary DILLON. We didn't think much. There didn't seem to be any opposition to it. It was part of our original proposal, and we did not notice any particular opposition to it in the House. I can't see that it would be of any particular problem to the taxpayer.

It does not apply to small sales. It only applies to large sales. I think there is a cutoff figure of something like \$3,000.

It only applies to properties that are over that, and what it is really designed for, there have been some very large sales, for instance of oil properties, things of that nature, where in effect they have been payable over 10 years, and there has been no interest specifically charged. Obviously there should be an interest charge which would be what you would have on a mortgage or something of that nature. This provision is to take care of that particular type of situation where the price has just been increased to take care of what would be the interest, converting it to capital gains.

Senator CURTIS. I think one of the leading cases on this in the Supreme Court of the United States is about 100 years old this year. If I recall the facts correctly, an individual had a piece of property that he was willing to sell for \$10,000. A prospective buyer said he wanted to buy it on installments. The seller then said, "I will sell it to you for 10 installments of \$2,000 each." That was his price, if he had to bother with it for 10 years.

The purchaser later brought an action charging usury, and the Supreme Court held that no part of that was interest.

I think the cases have been pretty uniform, both in Federal court and in the State courts, that an installment sale the difference between a cash price and an installment price was not interest.

Secretary DILLON. I think that is the present law. As I understand it, that is the reason for this provision, to take care of that situation.

Senator CURTIS. Now, do you regard the 4 percent dividend credit as a loophole?

Secretary DILLON. I regard the 4 percent dividend credit as a provision that was put into the law primarily to mitigate the very severe impact of the high personal income tax rates. I think it is not justified with the decreases in these high rates that we have now suggested. So if that is the definition of a loophole, it would be a loophole.

Senator CURTIS. Do you think it was not put in there as partial relief from double taxation?

Secretary DILLON. I think that there was certainly some talk about that; some consideration about that. That is a very difficult problem to determine.

There is a lot of feeling that corporations are separate, that there is not double taxation. Other people argue at length that there is double taxation.

But the effect of this thing has been to reduce the taxes on stockholders who are largely our more fortunate citizens, and we simply feel that with a substantial reduction in their top rates, and the top rates have been reduced slightly more, as you know, than the average reduction throughout the scale, that there is no longer reason for the maintenance of this.

Now, one reason it was put in, it was supposed to lead to more corporate financing by the equity route than by borrowing money. That did not turn out to be the case. So that argument in favor of it just did not work.

Senator CURTIS. More individuals own stock now than when it was enacted.

Secretary DILLON. Oh, yes; a great many more, but the proportion of the debt structure, the financial structure of the corporations is higher in debt now than it was when this was enacted. There have been a lot of small stockholders.

One reason obviously that that happened, the \$50 exclusion is a personal thing that can't be transferred automatically to a wife unless you transfer stock to her, so I think many small stockholders transferred stock to their spouses so that they could get the full benefit of the two \$50 exclusions. That actually increased the number.

In addition, there were a great many new plans for these mutual investment trusts that were sold rather aggressively, and they did not exist before, and a great many stockholders came in there.

If you look at the pattern of savings, the percentage of savings that have gone into stocks as compared to other things, it has declined rather than increased. More savings have gone into savings and loans, mutual savings banks, things of that nature, than have gone into stocks since the dividend credit was enacted.

Senator CURTIS. Of course, the stock prices have had something to do with that, too; isn't that true?

Secretary DILLON. With savings?

Senator CURTIS. No; the number of people who are anxious to buy stocks.

Secretary DILLON. Yes; I think also the good market led people to be interested in the stock market rise. I think you are quite right. I think that happened.

Of course, the bill as it has now passed the House increased the \$50 exclusion to \$100, which to the smallest stockholders is a substantial benefit.

Actually we find by our analysis of stockholdings that 2 million taxpayers who have stock will be benefited by the elimination of the dividend credit, and this increased exclusion. In other words, the increase in the exclusion is of more benefit to them than elimination of the dividend credit hurts them.

Senator CURTIS. Does the Treasury support the increase in the exclusion?

Secretary DILLON. Yes, we are glad to have that. We think this would help. Although we did not originally recommend it, we sup-

port it now. We think it would tend to help broaden the number of people who own stock. We think that is good.

Senator CURTIS. How many taxpayers will be taken entirely off the rolls by reason of the minimum standard deduction?

Secretary DILLON. Our best estimate is about a million and a half. That is out of the around 51 million taxpayers now on the rolls.

Senator CURTIS. Will it increase the number of refunds from withholding that will have to be made?

Secretary DILLON. No; I don't think it will increase the number of refunds from withholdings at all. There are a very substantial number anyway.

It may in some cases slightly increase the amount of the refund that will go to certain individuals, but I don't think it will increase the number of refunds. They probably would have refunds anyway.

Senator CURTIS. Is the purpose of this minimum standard deduction to more accurately reflect what the taxpayer pays out in taxes than in contributions, or is it intended as a tax reduction proposal?

Secretary DILLON. It is intended as a tax reduction proposal for those very lowest levels of our income strata. The benefits will go entirely to taxpayers with incomes of less than \$5,000.

Over half of it will go to those with less than \$3,000, who are right on the very fringes of subsistence in earnings.

Senator CURTIS. Among those people in the same income group, those who have considerable deductions in many items, they may be buying a home, they may be giving generously to good causes, they will not benefit by this.

Secretary DILLON. They will still be able to take their other deductions, but some who now itemize will find the minimum standard better.

Senator CURTIS. The person who will really be ahead in dollars is the individual who is paying either no local taxes or buying a home, which is usually the source of considerable interest deduction, and who is not making contributions.

Secretary DILLON. I think that is true, but I think that the reasons for that is that none of these people will be affected who have total incomes of less than \$3,000. These are not the types of individuals who can afford homes, or who could afford to make much in the way of contributions anyway.

One of the other things this does is to remove some of the discrimination which exists in present law unwittingly against the single individual, which came into effect when we passed, I think it was in 1948, the provisions for splitting income.

As a result the single individual bore a much heavier tax rate than a married couple. Now this will be alleviated somewhat by the minimum standard deduction. The minimum for one individual is \$300, and it goes up \$100 for each dependent, including the wife, so there is a particular advantage for the single individual.

Senator CURTIS. If this bill becomes law, and the predictions for its spurring the economy become true, what industries will be likely to expand by reason of this?

Secretary DILLON. I think all American industry will do better. The industries that cater to consumer demand will do better. The

industries that cater to capital goods will do better because there will be more factories built.

The basic industries will do better because there will be more demand for steel, aluminum, things of that nature, so I think this will be spread broadly throughout the economy.

Senator CURTIS. Will any of those industries in particular absorb the particular type of unemployment that prevails at the present time?

Secretary DILLON. Oh, I think that it will be absorbed by those industries and also by increases, parallel increases in the service industries.

I don't think by any means it will be all absorbed, because we are talking about reducing the 5½-percent rate to something like 4 percent, and as I think we have said before, we don't feel this bill can do the whole job.

It can set the framework, but we will need to pursue our efforts to improve structural unemployment, have training for displaced workers, better vocational training and things of that nature.

Senator CURTIS. What portions of this bill do you believe will be incentives for investment?

Secretary DILLON. There are incentives for investment by business and incentives for investment, risk taking, by individuals.

I think that reduction of the rate structure will mean that individuals will be more inclined to put a larger proportion of their assets in risk-taking ventures rather than possibly in tax free bonds, things of that nature.

I think that as far as business is concerned, that one element in the bill that is most particularly directed at that is the provision which modifies the investment credit so as to remove the present requirement for a reduction in basis.

The other major element is of course the reduction in the corporate tax itself, which will mean that profitability of any investment will be increased by something over 8 percent.

Senator CURTIS. Do you think any of that will be offset by the elimination of the 4-percent dividend credit?

Secretary DILLON. No, I don't think that would have any effect on that at all.

Senator CURTIS. You state that the wholesale price level had not changed. Is that the average price?

Secretary DILLON. Yes, that is the wholesale price level of the Bureau of Labor Statistics, which takes into account some 500 or more different items, and it shows remarkable stability over the last 3 or 4 years, presently at 100.7 percent of the 1957-59 average, which is exactly the same average that it happened to have in 1958.

Senator CURTIS. Now I am told that at the present time the dollar, based upon the 1959 dollar, is worth 42.2. Is there any relation to that and the price level?

Secretary DILLON. Obviously yes. There was a great deal of inflation, a great deal of change in our price levels as a result of the war and the postwar period, but that came to a stop. Looking backward we can see when it happened. It happened in about 1958. Since then prices have remained relatively stable.



Senator CURTIS. About 10 years ago the dollar was worth about 52.7, was it not?

Secretary DILLON. If you say so. I accept your figure.

Senator CURTIS. How will this bill, so far as the speedup is concerned, how will it affect the small corporations?

Secretary DILLON. I don't think it will have any effect because the speedup only affects that portion of the tax liability of any company that is in excess of \$100,000 annually, which means that a corporation has to have annual earnings before taxes of some \$200,000 before there can be any effect whatsoever from this provision.

Now, I think the average company makes something like 5 percent on sales, so that means you have to have a company which is selling something in the neighborhood of \$4 million or more annual sales before there is any effect.

That is not a particularly small company. That is a medium-sized corporation. Thereafter the effect is minimal, until it gets to be a much larger corporation, because the first \$100,000 of tax liability is not affected.

Senator CURTIS. That leads me to my next question. What does the bill passed by the House do with reference to more or less common ownership or multiple corporations?

Secretary DILLON. What the House bill did in this connection was simply this: the House bill provides that there will be a reduction in the normal tax rate from 30 percent to 22 percent, which helps the small corporation very substantially, the corporation that needs money, has to live off its own earnings, and has limited access to credit.

They get about a 27-percent reduction. The House felt that something was necessary to prevent this benefit, designed for small business, to flow over to the large business which took the form of multiple corporations but was really one enterprise.

Therefore the House provided that there would be a penalty tax on any company that was made up of multiple corporations and used multiple surtax exemptions, so that the rate on the first \$25,000 for those corporations instead of being 22 percent would be 28 percent.

There was a 6-point penalty. The net effect of that is that on those corporations they get the same reduction in their overall taxes as a large corporation.

The first \$25,000 in taxes is reduced  $6\frac{2}{3}$  percent, and the remainder is reduced, their overall tax is reduced from 52 to 48, which is a reduction of about 7.7 percent.

Senator CURTIS. Now, for this purpose, what is considered common ownership, what percent of the stock?

Secretary DILLON. Any company that is 80 percent owned by one parent is included.

Also, a special provision includes corporations which are owned by one family, one man, or a man and his wife, 80 percent. They are also called multiple corporations.

Senator CURTIS. Does it just apply to the hereafter acquired corporations, or does this apply to—

Secretary DILLON. No; it applies to all of them, because if there was not such a provision, there would be, in effect, a special gain or a windfall to this type of corporation which would get a greater corporate reduction than a large corporation which happens to operate through branches.

Of course, on the other hand, the House bill also repeals the present law which has a 2-percent penalty tax on filing a consolidated return. So that is repealed, and that favors the filing of consolidated returns which seems to be good accounting practice, and should be done.

Senator CURTIS. Under existing law, what is the rate of tax for corporate income up to \$25,000?

Secretary DILLON. 30 percent.

Senator CURTIS. And under the bill as passed by the House, if it is a single corporation, it would be what?

Secretary DILLON. 22 percent.

Senator CURTIS. But if one family or one individual coming within the definition here owns five corporations, each one makes, say, near \$25,000 but not over, each one of those would be taxed at 28 percent.

Secretary DILLON. Unless they elected to have only one exemption, the first \$25,000 of income of each is taxed at 28 percent.

Senator CURTIS. There are certain types of businesses where the one common investor may expand to a new neighborhood and buy an existing business, and this is not a result of a deliberate splitup of the organization, but he actually buys a new corporation. This provision would apply anyway, would it not?

Secretary DILLON. This would apply anyway, under the theory not that he is doing something morally wrong or even doing anything for tax reasons, but on the basis that the 22-percent rate is designed to help a really small business that does not have financial assets at its disposal, and needs that sort of help.

If a person has the ability to own several companies, presumably he has more financial assets, and he does not need that special benefit.

There is no implication, and that is made very clear in the House report and the bill, that there is anything evil with having multiple corporations. They often are necessary because they often are required by State law. If you operate in various States, you have to have different corporations.

Senator CURTIS. Of course, two is multiple, isn't it?

Secretary DILLON. That is right.

Senator CURTIS. If a country weekly newspaper owns one paper, that is incorporated, and the same owner is induced to buy a paper in an adjoining town, that second paper will pay 28 percent.

Secretary DILLON. That is right; both papers would unless they elected to take only one surtax exemption.

Senator CURTIS. And it may have to compete with another organization that is paying 22 percent.

Secretary DILLON. I wouldn't imagine so, because I would imagine that in the instance you have cited of a newspaper, there would not be room for two papers that were only earning that much money in one town, at least it would be very exceptional.

Senator CURTIS. Well, I think I know of just such a case.

Secretary DILLON. There may be such a case. You will probably almost always find particular cases, but there wouldn't be many.

Senator CURTIS. No, I think in an agricultural area that there are a number of corporations that are successful business operations, but by the time they pay all their ordinary expenses and salaries, their earnings do not exceed \$25,000 a year, and if they establish the second

business, whether it is a grain elevator, a lumberyard, a newspaper, or whatnot, that expansion from one to two, that new unit pays 6 percent more in taxes than its competitors.

Secretary DILLON. That is what the House bill provides, and we thought that was fair. They pay less than they pay now. They still get a tax reduction, but they would pay 6 percent more than an independent single corporation. They would still pay a very low rate compared to the big rate.

Senator CURTIS. Was this in the Treasury's recommendations?

Secretary DILLON. The Treasury's recommendations—original recommendations were more stringent than this, but this is what the House finally adopted.

Senator CURTIS. What is the Treasury's present position?

Secretary DILLON. The Treasury's original position was that we felt there was an area of abuse in the multiple-corporation area, again not necessarily by desire to avoid taxes, but where an unearned benefit was being given to certain companies that operated in the multiple form, and many of them are listed in some exhibits that we have attached to our testimony here. They were large corporations. On incomes of \$1 million or more, instead of paying taxes near 52 percent, they paid as low as 33 percent.

We felt that should be changed, and that there should be a more stringent regulation so this benefit of the low tax on the first \$25,000 really would go only to the small business.

Now, the House did not go along with that philosophy. However, they did recognize that by making this reversal of rates in the corporations, which would help the small business, which everybody seemed to favor; there would be an added windfall to this type of operation, or an added incentive for other companies that might now operate as branches to change to this, so therefore they put in the 6-percent tax, which more or less continues the present situation.

In other words, the multiple corporation has about the same advantage as it had before, but no more. This is what the 6 percent does.

Senator CURTIS. But in changing it, they did, in effect, apply the same increased tax on two corporations as—

Secretary DILLON. I think that probably one new approach is involved. Where they were dealing with parents and subsidiaries, it kept the situation about as it is, but they also applied it to this other type of corporation where one individual or one family owned more than one business, and I think that is a new approach in the law.

Senator CURTIS. It could mean that one small business would be operating outside a competitor, and have about a 27 or a 28 percent greater tax burden.

Secretary DILLON. The difference between 22 and 28 percent, I assume, Senator; yes.

Senator CURTIS. Mr. Secretary, knowing you are busy, I have five questions here that are written out that relate to group term insurance, and also interest deductions when borrowing on life insurance. I will submit them to you and you can make your answers, and that will save time, Mr. Chairman.

That is all I have.

Secretary DILLON. Fine.

(The questions submitted by Senator Curtis and the replies furnished by Secretary Dillon follow:)

QUESTIONS SUBMITTED IN WRITING BY SENATOR CURTIS TO SECRETARY DILLON AND ANSWERS OF SECRETARY DILLON SUBSEQUENTLY PREPARED IN RESPONSE

Question No. 1. As I understand it, group term insurance was as far back as 1920, by ruling, held not to be income.

The 1920 ruling stated: "The financial benefits under these policies do not move to the employees personally, but only to their heirs or dependents after their deaths, and the payment of the amount of the policy is, in any case, contingent upon the employee's continuance until death and his present employment which may be terminated at any time, either by himself or his employer, and upon the continued payment of the premiums by the employer. The employee has no option to take the amount of the premiums paid for the policy covering his life instead of the insurance. The policy has no paid-up value either to the employer or his employee. Such insurance creates no debt on the part of the employer, pays no debt to the employee, and discharges no legal obligation resting upon the employee. The premium paid therefore is in no sense 'gain derived' or realized or capable of being realized by the employee in dollars and cents, but only in the feeling of contentment that provision has been made for dependents. It is paid by the employer not as compensation to the employee, but as an investment in increased efficiency. It is therefore not income to the employee."

Why do you no longer believe that this ruling, which has been in effect since 1920, does not present valid reasons for treating group term insurance protection as not being taxable income?

Answer. The context in which the 1920 ruling was adopted is no longer valid. In 1920, provision of group term life insurance for employees was not a widespread practice and, where it was provided, the coverage was small, usually \$500 or \$1,000. At the present time group term life insurance is a widespread form of employee benefit involving over 43 million employees. Moreover, the amounts of insurance have become increasingly larger with some high-paid executives receiving close to \$1 million of protection. These factors, combined with the present high tax rates, have operated to make group term life insurance a valuable economic benefit and a favored means of enabling high-income taxpayers to avoid paying for substantial amounts of personal life insurance out of after-tax dollars. In recognition of this, group term life insurance should be subject to tax—at least when the amount of insurance reaches some minimum level—as are other forms of compensation.

Congress has specifically recognized that term life insurance is an economic benefit that should be included in the tax base. Under section 72(m)(3) of the Internal Revenue Code, an employee must include in income the value of life insurance (including group term life insurance) which is purchased for him under a pension trust with either contributions of the employer or earnings of the trust. Moreover, employees are subject to tax if their employers purchase them individual term life insurance policies. The provision in the House bill would remove the present inconsistency in the tax treatment of employer-provided life insurance by also subjecting group term life insurance to tax.

Question No. 2. It is my impression that the group term insurance provision will be quite complicated for the employers to compute. Could you explain this provision including the special deduction under it which is made available in certain cases and then tell us why the small amount of revenue you would obtain from this justifies this additional complications?

Answer. There are various features in the House bill which will minimize any administrative burdens on the employer. However, first let me briefly explain the provisions in the House bill. Basically, the amount taxable to the employee would be computed as follows: The value of his group term life insurance in excess of \$30,000, less the contributions made by the employee. A table of uniform premiums will be provided for use in valuing the group term life insurance. These premiums will be on the basis of 5-year age brackets.

Group term life insurance which is provided for an employee after he retires, or becomes permanently disabled, would be exempt from tax. If an employee continues to work after reaching age 65, he would still be taxable with respect to group term life insurance but the value per \$1,000 of protection would be frozen to that applicable at the 60 to 64 age bracket (\$24.67).

The value of group term life insurance which is taxable to the employee would be treated as additional compensation subject to withholding.

Under some employer group term life insurance plans, the younger employees actually contribute more than the cost of their insurance. This is particularly true when the employees contribute a flat amount per \$1,000 of insurance, regardless of age. In such a case, the House bill grants the employee a tax deduction for the difference between the amount he pays for insurance over \$30,000 and the value of the insurance over \$30,000. The value, for this purpose, would be computed under the uniform premium table.

The special deduction would involve no additional computations for the employer. The amount of the deduction would be computed by the employee on his tax return. The computation would be relatively simple—the employee would merely determine how much he paid for the insurance over \$30,000 and then subtract from that figure the value (computed from the uniform table) of the insurance over \$30,000.

For an employee who is subject to tax on his group term life insurance, the employer would merely compute the value of his insurance over \$30,000 and then subtract what the employee himself paid for the insurance (including that under \$30,000). The difference represents the amount on which the employer would withhold tax. The following factors tend to mitigate any administrative burdens on the employer in this respect:

(1) *Few employees involved.*—Because of the \$30,000 exclusion, the provision would affect less than 1 percent of the employees presently receiving group term life insurance from their employers. Thus, the special tax computations will need be made by an employer with respect to only a small minority of his employees.

(2) *Uniform premium table.*—A uniform premium table will be issued for use in computing the taxable value of group term life insurance. This will relieve the employer of having to request individual premium figures from the insurance company. The uniform premiums will not vary from year to year (subject to periodic revision to conform to new mortality tables and other factors). Provision is made in the House bill for use of the actual premium cost under the policy. However, since the uniform premiums do not include any loading factor, it will be a rare case when the actual policy cost will be lower. The only case the Treasury knows of where the actual cost may be lower is a group term life insurance plan for the employees of a life insurance company.

(3) *Five year age brackets.*—The uniform premium table is based on 5-year age brackets; that is, the premium for an employee will change only once every 5 years. This should substantially reduce the administrative work for the employer since the valuation factor will remain constant for an employee for a 5-year period, thereby minimizing the necessity for recomputation. Within a 5-year period, recomputation for an employee will only be necessary if his level of coverage changes. Presumably, the amount of coverage will change only with a change in basic salary. In such a case, the employee's payroll record will have to be recomputed in any event and it should not pose significant extra problems to include group term life insurance in this recomputation.

Since group term life insurance—especially when in excess of \$30,000—does represent a valuable economic benefit to the employees involved, it would appear that the equity of having this included in the tax base justifies the additional administrative computations by the employer.

Question No. 3. Won't taxing group term insurance and especially the complications involved in the provision tend to discourage employers and employees from taking out group term insurance? Do you believe that this is good for the country? If it is a desirable policy to exempt group term insurance up to \$30,000, why is it not desirable to exempt it above this level as well?

Answer. Theoretically, any amount of group term life insurance represents an economic benefit to the employee and therefore additional compensation when provided for him by his employer. However, the House Ways and Means Committee thought it desirable to continue the tax exemption for up to \$30,000 of insurance. Some people have argued that the exclusion should be in terms of a multiple of salary; for example, insurance up to two times salary should be exempted. Such an exemption formula would permit inordinately large amounts of insurance to be received tax free by highly paid executives. For example, an executive receiving an annual salary of \$200,000 would, if the multiple factor were 2, be permitted to receive up to \$400,000 of tax-free insurance. The fact that an individual has a large salary should not entitle him to a greater tax exemption than that granted lower income employees.

The proposed tax should not discourage the provision of group term life insurance for employees. First, only those receiving more than \$30,000 of insurance

would be affected—presently, this represents about one-half of 1 percent of all the employees receiving group term life insurance from their employers. Even for those employees receiving over \$30,000 of insurance, there would be little reason to reduce their insurance to the exclusion level. This is because the maximum tax would be considerably less than what the employee would have to pay if he bought the insurance himself. The maximum tax per \$1,000 of insurance would be \$17.27 for an employee in the 70-percent tax bracket. Under a typical group term life insurance plan adopted by one professional association, the employee, at age 65, would pay about \$33 for \$1,000 of coverage.

Question No. 4. Under this bank loan insurance provision as I understand it, an interest deduction will be denied—with certain exceptions—where the individual involved follows a systematic plan of borrowing the premiums to pay life insurance. Doesn't this test involve subjective intent? How can you distinguish when an individual is borrowing to pay premiums on his life insurance from cases where he is borrowing for other purposes?

Answer. The provision in the House bill contains basically the same test as is presently applied under section 264 of the Internal Revenue Code in the case of borrowing to purchase or carry a single premium insurance policy. This test applies a legal standard based on intent; however, observable facts are the major basis for determining whether the proscribed intent exists. Moreover, it is believed that the provision will, in effect, be self-enforcing in that it will deter the active selling of minimum deposit and bank loan arrangements as a tax avoidance device. It would seem that few taxpayers will enter into such a tax avoidance arrangement knowing that it could lead to a lawsuit. Such a deterrent on the selling of these tax avoidance plans will go a long way toward eliminating the abuse without the need for even actively applying the provision.

In addition, there are special, clearly objective, exceptions to insure that the interest deduction will not be denied where tax advantage is not the primary motive for the borrowing. First, since bank loan and minimum deposit plans adopted for tax reasons generally involve borrowing to pay the premiums right from the outset of the life insurance policy, the new provision would not apply where four of the first seven annual premiums are paid without borrowing. Second, the provision would not apply to any borrowing incurred because the taxpayer incurred unexpected expenses (such as medical expenses) or because the taxpayer encountered an unforeseen loss of income (such as a layoff from his job). Third, the provision would not apply where the interest involved is minimal—that is, less than \$100. Finally, it would not apply where the borrowing was incurred in connection with the taxpayer's trade or business, such as to finance a new plant.

Question No. 5. As I understand it, under the bank loan insurance provision in the House bill the denial of the interest deduction applies only if there had been borrowings with respect to four out of the first seven premiums on a policy. Won't this mean that those who have enough money can still avoid tax under this provision by paying the premiums for the first 4 years and then borrowing subsequent premiums?

Answer. It is true that the bank loan proposal would not apply if the taxpayer pays at least four of the first seven annual premiums on the policy without borrowing. Although it is possible for a taxpayer to avoid the provision by paying the first four premiums and then entering into the borrowing arrangement, it would not seem that many taxpayers will do so knowing that the tax benefits will be postponed 4 years. Moreover, it is alleged that bank loan and minimum deposit insurance arrangements are sold mainly to individuals who can afford to carry the insurance involved only because the tax benefits substantially reduce the cost of the insurance. If this is true, then it would seem that such individuals would not enter into such an arrangement if they had to pay the first four premiums in full. For instance, under a typical minimum deposit plan involving \$100,000 of insurance that has come to our attention, the first four premiums amount to a total of about \$8,250 (taking into account dividends), which is about \$5,220 more than the insured would pay if he took advantage of the maximum borrowing permitted during the first 4 years of the policy. There is considerable doubt that an individual would be willing to invest the additional \$5,220 in order to obtain a tax advantage which is not available until the policy has been in effect 4 years.

In other words, the provision in the House bill will primarily operate as a deterrent to the selling and entering into of bank loan and minimum deposit insurance arrangements as a tax avoidance device.

Senator SMATHERS. All right. Thank you very much, Mr. Secretary.

Apparently there are no other Senators who, at this time, wish to question you, Mr. Secretary, and so we thank you for your testimony, which I think has been most instructive and helpful to every one of us. We will excuse you with thanks.

Secretary DILLON. Thank you, Mr. Chairman.

Senator SMATHERS. Is the Director of the Bureau of the Budget in the room, by chance?

Mr. Gordon, if you would come up, we will have a little informal colloquy here.

(Discussion off the record.)

Senator SMATHERS. Our next witness will be the Director of the Budget, Mr. Kermit Gordon.

In light of the fact that so few Senators are now here, and because of the importance of your particular testimony, would it be agreeable to you to have your prepared statement inserted in the record at this point and come back Monday afternoon for questioning by the members?

Mr. GORDON. That will be entirely agreeable, Mr. Chairman.

Senator SMATHERS. Thank you very much.

(The statement referred to follows:)

#### STATEMENT OF KERMIT GORDON, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. Chairman and members of the committee, I welcome the opportunity to appear before this committee, to assist in its consideration of the proposed Revenue Act of 1963. Tax reduction and reform must be considered in the light of the expenditure situation and outlook. My purpose in appearing before you today is to discuss Federal expenditures—present and prospective—in the light of the administration's tax proposals.

Let me begin by emphasizing what I regard as the central point in the current interplay of tax and expenditure policy: The fiscal stimulus which the American economy today so clearly needs could be provided, in principle, either by a substantial increase in Federal expenditures or a substantial reduction in tax rates. The administration has chosen the latter road—economic expansion by means of an increase in private demand. The corollary of this decision is clear: If we are to avoid an excessive expansion of total demand, and if we are to whittle away and eliminate the Federal deficit as an expanding economy generates increased tax revenues, we must restrain, sharply, the growth of Federal expenditures. This is the premise on the basis of which we are making our budgetary plans today.

In so doing, we are carrying out a policy which the President announced at the time he proposed his tax reduction program last January. In his budget message of January 17, the President said:

"\* \* \* the prospect of expanding economic activity and rising Federal revenues in the years ahead does not mean that Federal outlays should rise in proportion to such revenue increases. As the tax cut becomes fully effective, and the economy climbs toward full employment, a substantial part of the revenue increases must go toward eliminating the transitional deficit."

The President reaffirmed this position on August 19 in a letter to Chairman Mills of the House Ways and Means Committee:

"\* \* \* tax reduction must \* \* \* be accompanied by the exercise of an even tighter rein on Federal expenditures, limiting outlays to only those expenditures which meet strict criteria of national need."

In the light of this clear guidance, on the basis of which we have been formulating our budgetary policies, I would like to review the expenditure picture for fiscal years 1963, 1964, and 1965.

#### CURRENT BUDGET OUTLOOK

##### *Fiscal year 1963*

The fiscal 1963 administrative budget deficit was \$6.2 billion, \$2.6 billion below the January estimate, and \$0.2 billion less than the fiscal 1962 deficit. (The

deficit in the more comprehensive cash consolidated budget was \$4.1 billion, or just half the January estimate.) One-third of the decrease in the administrative budget deficit from the January estimate came from higher Federal revenue collections, and the remainder from lower expenditures. The expenditure reductions were widespread, reflecting better than anticipated results from the policy of substituting private for public credit, economies in operations, and program changes.

Total expenditures for the year were \$92.6 billion, a decrease of \$1.7 billion from the \$94.3 billion estimated in January. The accompanying table 1 summarizes the fiscal 1963 budget, showing changes between the January estimates and the actual results for the fiscal year.

The largest single factor in the decline in expenditures developed from the administration's active efforts to transfer to private ownership Government-held mortgages and other financial assets; these efforts resulted in the sale of \$0.8 billion more of financial assets than anticipated in January from the portfolios of the Veterans' Administration, the Export-Import Bank, and the Housing and Home Finance Agency. The intensified program of substituting private for public credit follows the policy announced in the 1964 budget, and is in line with recommendations of the Federal Credit Programs Committee in its Report to the President last February.

Almost all other agencies spent less than had been estimated earlier. Some general factors which led to this result included: (1) The comprehensive program for better manpower management established by the President in the fall of 1962, which played an important part in holding the increase in Federal civilian employment to 5,600 during fiscal 1963, considerably under the January estimate; (2) the absorption of over 40 percent of the pay increases taking effect during the fiscal year; and (3) the steadily increasing emphasis within the administration on management improvement and cost reduction.

TABLE 1.—Summary of administrative budget expenditures in fiscal year 1963

[In millions of dollars]

	January estimate	Actual	Change from January
<b>Budget expenditures, by agency:</b>			
Department of Defense, military functions.....	48,300	48,249	-51
Foreign assistance, military.....	1,750	1,711	-39
Atomic Energy Commission.....	2,870	2,758	-112
National Aeronautics and Space Administration.....	2,400	2,552	+152
Interest on the public debt.....	9,700	9,891	+191
Subtotal.....	65,020	65,161	+141
Legislative branch and the judiciary.....	224	209	-15
<b>Funds appropriated to the President:</b>			
Foreign assistance, economic.....	2,100	2,034	-66
Public works acceleration.....	300	62	-238
Other.....	209	142	-67
Department of Agriculture.....	7,493	7,763	+270
Department of Commerce.....	745	667	-78
Department of Defense—civil.....	1,106	1,128	+22
Department of Health, Education, and Welfare.....	5,048	4,904	-144
Department of the Interior.....	1,054	1,028	-26
Department of Justice.....	317	317	—
Department of Labor.....	239	253	+14
Post Office Department.....	802	755	-47
Department of State.....	457	405	-52
Treasury Department, other than interest.....	1,111	1,133	+22
Housing and Home Finance Agency.....	1,088	400	-688
Veterans Administration.....	5,532	5,173	-359
All other.....	2,112	1,571	-541
Subtotal.....	29,937	27,944	-1,993
Deduct interfund transactions.....	646	613	-133
Total expenditures.....	94,311	92,590	-1,721

Thus, the administration, in 1963, laid the groundwork for the tight budget policies which are being carried over into the present fiscal year.

#### Fiscal year 1964

Normally, at this time of the year, the Bureau of the Budget would revise the January budget estimates and make firm estimates of the current year



budget totals—estimates based on final congressional action. However, for the fiscal year 1964, a description of the outlook at this time must of necessity be highly tentative, because congressional action on 1964 appropriations is still incomplete. Although we are nearly one-third of the way through the current fiscal year, only 4 of the 12 regular appropriation bills have been enacted by the Congress. Two others have been passed by both Houses but have not yet been reported out of conference. In addition, substantive legislation before the Congress could still be enacted this session with substantial effects—up or down—on the 1964 budget totals.

For these reasons, the revised figures I am about to present for 1964 expenditures must be regarded as highly conjectural. In preparing these revisions, we have been deliberately conservative, for we do not want to raise expectations of expenditure reduction which may not materialize. I have no doubt that before we finish preparing the 1965 budget document, there will be a number of changes—positive and negative—in the components of 1964 expenditures. Because we have been intentionally conservative in our estimates, I believe it is quite possible that the 1964 expenditure total will be somewhat less than the level we are now projecting.

It now appears that expenditures will be about \$97.8 billion, a decline of \$1 billion from the January estimates. The lower level of expenditures seems likely despite some unforeseen increases, and takes into account the effects of amendments to the 1964 budget submitted by the President, reductions already made by the Congress, and possible further reductions, as well as other factors. The effects on the 1964 budget of the projected wheat sale to the Soviet Union are currently being examined but, since the detailed negotiations have not yet begun, it is not possible to make a precise estimate of the impact on fiscal 1964 expenditures at this time.

TABLE 2.—Changes in outlook for 1964 administrative budget expenditures

[In billions of dollars]

Expenditures as estimated in January.....	98.8
Changes since January:	
Presidential budget amendments.....	— .2
Expected effect of congressional action on appropriations.....	—1.3
Additional savings in Department of Defense, excluding those resulting from appropriation cuts.....	— .4
Additional sales of mortgages and other financial assets.....	— .2
Commodity Credit Corporation farm price-support program re- estimate based in later information.....	+ .4
Interest on the public debt.....	+ .5
All other, net.....	+ .2
Net change.....	—1.0
Current expenditure estimate.....	97.8

Since January, the President has sent to the Congress several amendments to the 1964 budget which reduced the requests for new obligational authority \$620 million below the budget estimates. These are estimated to reduce 1964 expenditures by about \$200 million.

The expenditure effect of congressional reductions in the four appropriation bills thus far enacted and the possible effect of future congressional action is tentatively estimated to amount to about \$1.3 billion in 1964. There are several factors which explain why expenditure reductions in 1964 will be less than the total cut in appropriations:

1. For these programs that have a long leadtime from the obligation to the expenditure stage, a reduction in appropriations often does not result in a reduction in expenditures until later fiscal years. For example, most of the expenditure effect of appropriation reductions in foreign aid, in NASA, and in defense procurement and research and development would occur after fiscal 1964.

2. Some reductions in appropriations will not directly affect spending at all. For example, a \$100 million reduction by the Senate for reimbursement of net losses already realized by the Commodity Credit Corporation will have no impact on expenditures.

3. Some reductions in appropriations represent a difference of opinion between the Congress and the administration on the probable cost of programs which are mandatory under the law. For example, it appears that a large part of the

\$175 million reduction in the appropriation for State grants for public assistance will be needed and will have to be restored next year.

Other changes in the expenditure outlook stem from a number of factors. It now appears that sales of mortgages and other financial assets in fiscal year 1964 may total \$200 million more than estimated in January, and budget expenditures will thereby be reduced by this amount. Moreover, savings within the Defense Department over and above the reductions in expenditures due to appropriation action, are estimated to total an additional \$400 million.

On the other hand, expenditure estimates have been increased in two areas because of developments since January. The interest cost on the public debt is estimated to be up by \$500 million, reflecting a higher average level of short-term interest rates. The latest information from the Department of Agriculture on crops and related data indicate that the cost of the farm price-support program may also be \$400 million more than had been estimated in January. These higher outlays reflect larger-than-anticipated expenditures on cotton and feed grains, partly offset by larger commodity sales abroad.

#### FUTURE EXPENDITURE OUTLOOK

##### *Fiscal year 1965 and beyond*

Let me turn now to the expenditure outlook over the next few years. We are now in the early stages of reviewing agency requests for the 1965 budget. Decisions on specific programs have not yet been reached, nor could they be, since action on 1964 appropriations has been completed only recently for some agencies and is still pending for others. Firm forecasts, therefore, cannot be presented at this time. I can, however, make clear our intentions with respect to expenditure policy, and examine some of the factors affecting the expenditure outlook for major sectors of the budget.

As I indicated earlier, our basic policy instruction has been provided by the President through his budget message last January and through various statements since that time; namely, that as the tax cut becomes fully effective and as the economy moves toward full employment, a substantial part of the increased tax revenues should be applied toward reducing the budgetary deficit. More specifically, the President undertook, in his letter to Chairman Mills of August 19, to reduce the fiscal year 1965 budget deficit below the \$9.2 billion deficit foreseen for fiscal year 1964. Since the largest impact of the tax cut on budget revenues will occur in fiscal year 1965, fulfilling this pledge will require the strictest expenditure control. Indeed, as I shall spell out at a later point in this statement, the sharp increase in workloads and demands on the Federal Government—arising out of a growing economy and rising population—mean that the policies we are adopting involve a rigorous approach to budgetary control.

In accordance with this clear expenditure policy, stringent guidelines have been given to the agencies to be followed in the preparation of their 1965 budget proposals. At the President's direction, I wrote to agency heads in August to notify them of the general policies which will guide formulation of the 1965 budget. In this letter, I said: "The proposed cut in taxes is essential to help move the economy to full employment. As the economy responds to the stimulus of the tax cut and approaches full employment, budget receipts will be higher than they would have been without the cut in tax rates. However, the tax cut will cause a temporary lag in budget revenues." I emphasized the President's determination "to maintain a particularly tight rein on budget expenditures during this period of curtailed revenues." In accord with this mandate, I informed them that "All agency requests will receive the most critical review in the light of the President's overall fiscal objectives and priorities, and the needs in other agencies of the Government. It is expected that agency heads will take a similarly critical approach in preparing their budget submissions."

My letter also called special attention to the need for carrying out the administration's program for effective manpower management and its user charge policy, about which I shall say more in a few minutes.

Let me now state the general principles which we are applying to guide the budgetary process:

First. We will propose only those expenditures which meet strict criteria of satisfying pressing national needs. The budget submitted in January for fiscal year 1961—except for defense, space, and unavoidable interest charges—called for lower expenditures than in the prior year. If all three budgets of this administration—1962 through 1964—are looked at together, they illustrate the

same point. The great bulk of the increase—actually 70 percent of it—has been in the defense, space, and interest category.

Over the 3-year period from 1961 to 1964, budget expenditures for all other purposes taken together will increase by \$3.8 billion. This compares with an increase of \$5 billion in the same category over the preceding 3 fiscal years.

The reduction planned for 1964 was accomplished despite increases in a number of programs whose expenditures are closely related to the growth in the Nation's economy and population. To help achieve this result, \$0 billion was pared from civilian agency budget requests before the budget document was sent to the Congress. Since then, it has been possible to propose further reductions in 1964 requests, and we intend to continue and intensify our application of very strict tests of urgency in formulating the 1965 and later budgets.

Second. We shall continue our efforts to identify existing Federal programs which could, more appropriately and more effectively, be carried out by the private sector or in which non-Federal interests could bear a larger share of the costs. In the case of Federal credit programs, for example, we have instituted a policy of substituting private for public credit wherever feasible.

In the last fiscal year over \$1 billion of financial assets in Federal portfolios were transferred to private holders, and we plan to increase this total in 1964. We are now seeking to develop techniques which will allow a substantial expansion of these efforts in future years. Early this year the President proposed to the Congress that part of the direct lending program of the Farmers Home Administration be converted to an insured basis, under which private lenders, rather than the Federal Government, would make the loans.

These efforts to rely more heavily on private enterprise are not confined to the area of Federal credit programs. For example, a report prepared by the Civil Aeronautics Board, and now being reviewed, sets forth a program for gradually reducing Federal operating subsidies to local service airlines. An increasing percentage of our national outlays directed toward civilian use of atomic energy is being borne by private industry, with a corresponding decrease in Federal involvement. In planning new military hospitals, a policy was instituted last year to make increasing use of community hospitals to care for Armed Forces dependents, thus lessening the operating burden and ultimately the capital outlays for Federal hospital facilities. The electrical transmission grid for the Colorado storage project will be a joint Federal-private venture, rather than the originally proposed all-Federal system, saving the Federal Government some \$27 million in immediate costs.

All of these efforts reflect the philosophy of this administration that the Federal Government should not undertake new expenditure programs or continue old ones if their objectives can effectively be achieved by other means.

Third. In many cases where Federal expenditures convey special benefits or privileges to particular groups or individuals beyond those accruing to the public at large, the beneficiaries ought to bear a fair share of the costs involved. As a major step in carrying out this principle, the President recommended to the Congress a series of user charges for commercial and general aviation and for inland waterway transportation so that passengers and shippers would bear a more equitable share of the cost of services provided by the Federal Government. He has also recommended an increase in patent fees. On a full-year basis, these and similar charges would reduce the Federal deficit by \$250 million. We are seeking to identify other Federal programs in which the institution or expansion of Federal user charges would be appropriate.

Fourth. This administration has taken action in every department and agency to insure that the objectives of Federal programs are achieved at the lowest possible cost. These are not mere aspirations, but are backed up by solid results.

Some of the most dramatic savings in operating costs are resulting from Secretary of Defense McNamara's cost reduction program. This program—now a little over a year—old resulted in savings in excess of \$1 billion during fiscal year 1963, and the Secretary estimates that further actions now planned for this year and for 1965 will bring the ultimate savings to almost \$4 billion a year.

The cost reduction program is fully in effect today, and is reshaping procurement and management practices in the Department of Defense. But the drive for better management in the Federal Government extends far beyond the limits of the Department of Defense. Literally scores of improvements have been adopted throughout the Federal Government during the past few years which have the effect of increasing efficiency and saving money. In my opinion

a tight expenditure policy, such as we are now pursuing, provides a built-in incentive to the agencies to cut their costs and find savings with which to finance their increased workloads. Let me mention briefly just a few of the efforts underway today to get the public business done more efficiently, more speedily, and more economically.

The U.S. Government was the first user of automatic data processing equipment and is today the largest user in the world of electronic computers. Through the use of such equipment, for example, each employee of the Insurance Service of the Veterans' Administration today services 1,700 policies compared with about 350 policies in 1950. Over this period, the Veterans' Administration has reduced the number of employees required to handle its 6 million policies from 17,000 to 3,000.

Productivity improvements in the Post Office enabled that Department to reduce the number of its employees by 1,300 in fiscal 1963, despite an increase of about 1.2 percent in postal volume.

The Federal Government has one of the most extensive and productive employee suggestion systems in the country. Last year, Federal agencies adopted more than 100,000 suggestions submitted by employees. These suggestions yielded measurable savings of nearly \$65 million, for which employees received cash awards of nearly \$3 million.

We have only begun to appreciate the great contribution which improved efficiency in Government operations can make to budgetary control. But we have made encouraging progress, and we intend to continue and intensify our efforts to modernize and improve Government operations, to save manpower, to lower overhead, to try out new ideas and practices, and to shake up systems and procedures that have long been taken for granted.

Fifth. Hand in hand with control over expenditures goes control over employment. Federal civilian employment is being held substantially below the levels anticipated last January. In the last 12 months, Federal employment in the executive branch increased by only 78 persons, despite a substantial increase in workloads. At the same time, State and local employment has continued to grow—by roughly 300,000 persons last year and in every year since 1955.

The President made clear in a statement to the Cabinet last month his determination to hold Federal employment to the lowest possible level. The President said, "In the present fiscal year and the next, I ask every Cabinet member and every agency head to make certain that there is no slackening in our efforts to improve the control and utilization of manpower. In view of last year's achievement, the year-end employment estimates for the present fiscal year which appear in the January budget are already obsolete. I have asked the Budget Director to take the lead in developing new and tighter employment targets for the end of the present fiscal year, and to set them at levels which cannot be realized except through the introduction of further improvements in manpower management."

We are now engaged in working out with the agencies these lower employment targets.

Sixth. Every effort is being made to reduce the adverse effects of Government programs on the balance of payments. Both the Agency for International Development and the Defense Department have taken steps to reduce the dollar outflow of their programs. But while these two agencies account for the bulk of oversea payments, all areas of the Federal Government have undergone careful scrutiny to insure the maximum possible balance-of-payments savings.

To help cut the net dollar outflow from Government operations, the President asked the Bureau of the Budget to establish a procedure of estimates and controls over international transactions. In setting up this procedure, we asked each agency to review with special care its requirements for conducting activities abroad and to apply tighter criteria with a view to terminating, consolidating, or restricting those activities.

Since the initiation of this procedure (which has become known as the gold budget) in August 1962, the Bureau of the Budget has conducted quarterly reviews of the agency transactions. On the basis of the actions taken, we now expect the net dollar outflow from Federal activities to decline from approximately \$2.8 billion in 1962 and \$2.7 billion in 1963 to \$2.4 billion in 1964. Steps are already underway to achieve a further and even larger reduction in 1965. (These figures do not include special receipts of the Federal Government—prepayments of loans, advances on military exports, and receipts from Treasury sales of medium-term, nonmarketable securities.)

To help achieve these balance-of-payments savings, the Defense Department has increased military sales abroad, reviewed its requirements for foreign military bases and installations, reduced foreign spending of oversea personnel, altered its procurement policies, and launched over 60 special studies looking toward reduced foreign spending.

AID has stepped up its efforts to insure that aid funds are spent in the United States to the maximum possible extent.

In addition to these efforts by Defense and AID, numerous other steps have been taken to help reduce the balance-of-payments deficit:

Several agencies (primarily the National Science Foundation and the National Institutes of Health), which make grants for research abroad, are cutting back such programs as rapidly as possible and encouraging local support of the programs in the countries involved.

The Treasury has instituted a system for the payment of some social security, veterans' life insurance and civil service retirement benefits in excess local currencies—currencies which the United States owns in amounts well in excess of its needs.

The Peace Corps is investigating steps to secure host country support of local currency costs of its programs abroad.

The administration has requested the Congress to allow freer use of U.S.-owned foreign currencies reserved for specific programs. If approved, this proposal would permit such currencies, which would otherwise be held for periods up to 5 years, to be used to meet current needs.

The Budget Bureau has conducted a special review of U.S. Government offices and missions abroad. Among the results so far achieved have been plans by the State Department to close 13 posts and reduce strength in 3 others, plans by the U.S. Information Agency to close or curtail 9 offices abroad, and consideration by half a dozen other agencies of the elimination of certain oversea offices or a reduction in their strength.

Let me now turn from these general policies to an examination of budgetary prospects in some of the major areas of Government.

National defense expenditures have been a major element in the increase in total expenditures in the administrative budget in recent years. Is there any reason to expect that this rate of increase will slow down in future years? I believe that this is.

Since 1961, we have been improving and restocking conventional arms and equipment, training forces in their use, and vastly increasing the mobility of our forces. For example, from the end of 1961 to the end of 1964, active duty strength of the Army will have increased from 860,000 to 975,000; Air Force tactical air support for the ground forces will increase from 16 to 21 wings; and airlift capability will increase by 60 percent.

At the same time, the nuclear deterrent capability of our strategic retaliatory forces has also been strengthened. Over this period we will increase fourfold the number of Polaris submarines in commission. We are also providing for a force of 950 Minuteman missiles, of which 250 are already in place.

We are reaching, in other words, a new plateau of readiness in both our strategic and our limited war capabilities.

It is true that some components of our defense expenditures will probably continue to rise in the next few years—for example, the military pay raise will first be fully effective in fiscal year 1965 and there will probably also be increases for military pensions and research and development. We expect, however, that these increases will be balanced off in part by reductions in expenditures in other sectors. Also, the defense cost reduction program will, as I mentioned earlier, produce ultimate annual savings of \$4 billion and yield sharply increased effectiveness per dollar of outlay.

Any estimate of the trend of defense expenditures must allow for the possibility that unforeseen developments—particularly changes in the temperature of the cold war—may cause expenditures to change either upward or downward. But apart from such contingencies, our review leads us to conclude that we may look forward with some confidence to a leveling off of defense expenditures.

Expenditures on space have also been rising sharply. As the President made clear in his message of May 25, 1961, the decision to send a man to the moon involved a commitment to a costly course of action over a period of many years. A substantial increase is in prospect in 1965, though probably a lesser increase than in 1964. If we continue on the path of our present program, however, there

would appear to be a good chance that the rise in space expenditures will taper off after 1965.

Some rise in interest payments on the public debt can be expected to occur over the next few years as the Federal Government incurs transitional deficits on the path to a balanced budget.

#### *Other programs*

Expenditures for all programs other than defense, space, and interest amount to roughly 30 percent of the total. This sector covers a wide range of diverse activities such as veterans' benefits and services, agriculture programs, medical research, air safety, flood control, and water resource development, maintenance of our national parks and forests, foreign assistance, and housing and community development activities. Expenditures for these programs in the future will be affected by a large number of pluses and minuses; our purpose and responsibility is to find enough minuses to offset a large share of the pluses.

We cannot ignore the fact that there are basic forces which tend to push up expenditures. As former President Eisenhower pointed out in his 1960 budget message:

"\* \* \* inescapable demands resulting from new technology and the growth of our Nation, and new requirements resulting from the changing nature of our society, will generate Federal expenditures in future years \* \* \*. We must not forget that a rapidly growing population creates virtually automatic increases in many Federal responsibilities."

President Eisenhower's point can be illustrated by looking at what has been happening recently to our population and our economy.

By the end of fiscal year 1964, there will be 10 million more Americans than there were the day President Kennedy took office. In the very near future, we shall have a \$600 billion economy compared with the \$500 billion economy we had when President Kennedy took office.

The inevitable result of these pressures is to increase Government workloads. For example, between the fiscal years 1962 and 1964:

The number of tax returns will rise 2½ percent;

The volume of mail will grow 6½ percent;

The number of visitors to our national parks will increase by 5½ percent and to our national forests by 23 percent;

The number of veterans or survivors receiving pensions will rise by 11 percent;

The number of meals served to schoolchildren under the school lunch program will grow by 11 percent;

The number of passports issued will increase by 27 percent.

Estimates of future expenditures must also make allowance for new programs or expansions of existing programs to meet changing needs. A tight budget need not be a stagnant budget. In developing our future program and expenditure plans, we will have to continue to be responsive to the changing problems of a growing country. Proposed new programs or expansions of existing programs will be tested against the strict criteria of need and priority we intend to apply. At the same time, the funds needed to accommodate such new or increased activities will have to be found in considerable part through restrictions and savings accomplished elsewhere.

The 1965 budget will be the first prepared under my direction, and I would not want to prejudice the results before having an opportunity to reappraise all ongoing programs. From my experience to date, I know that cutbacks will not be easy. But when the Federal Government is spending nearly \$100 billion a year through the administrative budget, it has a compelling responsibility to the Nation to assure that the money is being spent where it is most needed. We intend to make every effort to honor this responsibility.

**Senator SMATHERS.** The meeting will stand in recess until 10 o'clock Monday.

Thank you.

(Whereupon, at 2:50 p.m., the subcommittee was in recess, to reconvene at 10 a.m., Monday, October 21, 1963.)