

# Calendar No. 289.

67TH CONGRESS, }  
1st Session. }

SENATE.

{ REPORT  
No. 275.

## INTERNAL REVENUE BILL OF 1921.

SEPTEMBER 26, 1921.—Ordered to be printed.

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

### REPORT.

[To accompany H. R. 8245.]

The Committee on Finance, to whom was referred the bill (H. R. 8245) to reduce and equalize taxation, to amend and simplify the revenue act of 1918, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments, and as amended recommend that the bill do pass.

#### EXPENDITURES AND REVENUES.

The revenue bill which your committee recommends is designed to produce enough revenue to meet without borrowing all ordinary expenditures, including \$265,754,865 for the cumulative sinking fund authorized by the Victory Liberty loan act. The bill is intended to provide some margin of safety, but not to create any current surplus over necessary expenditures.

#### FISCAL YEAR 1922.

The Secretary of the Treasury estimates that the expenditures for the fiscal year ending June 30, 1922, will aggregate \$4,034,000,000, an amount, it will be noted, in excess of the appropriations for the same fiscal year because of expenditures that must be made from available balances from prior or continuing appropriations. The principal receipts with which to meet these expenditures must come from internal taxes; but there are substantial receipts from customs and miscellaneous nontax sources, such as salvage, Panama Canal receipts, and the like. Customs and miscellaneous nontax receipts will yield, it is estimated, \$762,000,000, thus leaving \$3,272,000,000 to be raised by internal taxes. The new revenue bill, amended as your committee proposes, will yield \$3,326,600,000, which exceeds the

amount required from this source by only \$54,600,000—a margin of safety none too large for the fiscal year 1922 in view of the existing business depression and the uncertainty attaching to the yield of the income and profits taxes. The estimates and figures in detail will be found in the tables printed on pages 2, 6, and 7.

## FISCAL YEAR 1923.

It is not possible to make an accurate forecast of the expenditures for the fiscal year 1923, but your committee has acted on the assumption that—with the exception of the special railroad expenditures (transportation act and Federal control) which will be nearly if not wholly completed in the fiscal year 1922—the aggregate expenditure for the fiscal year 1923 will be substantially as large as in the fiscal year 1922. The special railroad expenditures included in the 1922 estimates amount, in round figures, to \$500,000,000; and the receipts from customs and miscellaneous sources for the fiscal year 1923 are estimated at \$700,000,000. Deducting both amounts (\$1,200,000,000) from the total estimated expenditures for 1922 (\$4,034,000,000) leaves in round figures \$2,835,000,000 to be supplied by internal taxes for the fiscal year 1923. The revenue bill as recommended by your committee will raise during 1923, it is estimated, \$2,740,400,000. The difference or deficit of \$100,000,000 can and should be avoided by savings and economies. Your committee deliberately recommends a tax program which, while providing revenue substantially sufficient to meet ordinary expenditures on the present scale, assumes that a reasonable measure of retrenchment and reduction will be accomplished. The total ordinary expenditures for the fiscal year 1921 including sinking fund and miscellaneous fixed debt charges, amounted to \$5,528,688,050. For the fiscal year 1922 the expenditures on the same basis are estimated at \$4,034,000,000. The above program assumes that for the fiscal year 1923 they will amount to approximately \$3,400,000,000, an entirely reasonable assumption in the light of our present knowledge.

TABLE I.—Revenue collected during the fiscal year ended June 30, 1921, and estimated revenue collections under existing law and H. R. 8245 during the fiscal years 1922 and 1923 (revised as of Sept. 19, 1921).

Source of tax.	Revenue collections during the fiscal year—		
	1921, actual collections.	1922, estimated.	1923, estimated.
Customs.....	\$308,664,391	\$275,000,000	\$350,000,000
Internal revenue:			
Income tax:			
Personal.....		800,000,000	750,000,000
Corporation.....	3,226,790,653	430,000,000	540,000,000
Profits tax.....		800,000,000	150,000,000
Back taxes, income and personal.....		250,000,000	300,000,000
Miscellaneous.....	1,309,210,111	1,210,000,000	1,000,400,000
Miscellaneous:			
Sale of public land.....		1,500,000	1,500,000
Federal reserve bank.....		60,000,000	30,000,000
Interest on foreign obligations.....	719,941,869	25,000,000	25,000,000
Repayment of foreign obligations.....		30,000,000	30,000,000
Sale of surplus war supplies.....		200,000,000	100,000,000
Panama Canal receipts.....		14,500,000	15,000,000
Other miscellaneous.....		150,000,000	150,000,000
Total.....	5,623,506,745	4,023,600,000	3,441,900,000

## CHANGES FROM THE PRESENT LAW AND FROM THE HOUSE BILL.

Existing taxes have been reduced in the bill recommended by your committee, and every class of taxpayers will share in the benefits if the bill is adopted. The effect upon the revenue collections of the proposed amendments as compared both with the present law and the House bill is shown in detail in Tables II, III, and IV following. The reductions in the miscellaneous taxes are given in detail in Table III.

For the fiscal year 1922 (as shown in Table II) the present law would yield \$3,460,000,000; the House bill, \$3,240,000,000; and the bill as reported to the Senate, \$3,326,000,000. The reduction in the individual income tax is due principally to the increase in the personal exemptions from \$2,000 to \$2,500 for heads of families having an income not in excess of \$5,000 and the proposed increase in the exemption for dependents from \$200 to \$400. This increase in the personal exemptions will reduce the collections (principally from taxpayers having incomes below \$5,000) about \$70,000,000 annually, but only part of this reduction will affect the revenue for the fiscal year 1922. The reductions in the miscellaneous taxes are shown in detail in Table III.

For the fiscal year 1923 the present law would yield \$3,340,000,000, the House bill \$2,660,330,000, and the bill as reported to the Senate \$2,740,400,000. The reduction in the individual income tax is due to the increase of personal exemptions described above and to the proposed reduction of the surtaxes effective January 1, 1922. The House bill limits the surtaxes to a maximum of 32 per cent upon incomes exceeding \$66,000, but otherwise retains the present schedule of surtax rates. In the bill as reported to the Senate the same maximum rate of 32 per cent is retained, but the surtaxes applicable to incomes under \$66,000 have been moderately reduced, resulting in a reduction of revenue, as contrasted with the House bill, of approximately \$15,000,000 a year.

For the fiscal year 1923 the corporation income tax shows a gain, due to the proposed increase of rate from 10 per cent to 12½ per cent in the House bill and from 10 per cent to 15 per cent in the bill as reported to the Senate, the change to be effective January 1, 1922. In both the House bill and the Senate draft the excess-profits tax is repealed as of January 1, 1922, but collections based upon income for the year 1921 will continue to be made in the first half of the fiscal year 1923.

For the fiscal year 1923 the miscellaneous internal taxes have been reduced in the House bill, as contrasted with the present law, \$359,670,000. The similar reduction in the bill as reported to the Senate amounts to \$324,600,000. The details of these reductions are given in Table III.

From the standpoint of revenue the most important changes recommended by your committee are:

The repeal of the excess-profits tax, which would reduce the revenue about \$400,000,000 annually; the repeal of the surtaxes in excess of 32 per cent, involving an immediate loss of \$80,000,000 to \$90,000,000 a year; the repeal of the capital-stock tax, involving an annual loss of about \$75,000,000; the reduction of the transportation

taxes by one-half on January 1, 1922, and their final repeal as of December 31, 1922, involving a reduction of \$181,000,000 during the calendar year 1922 and an eventual loss of \$262,000,000 per year; and the adoption of an additional income tax upon corporations of 5 per cent, which would increase the revenue about \$260,000,000 annually.

#### EXCESS-PROFITS TAX REPEAL.

The excess-profits tax has been so thoroughly discussed that it is unnecessary to state at length the reasons which have led your committee to recommend its repeal. The time for discussion is past; and the time to repeal the tax has arrived. It may be mentioned, however, that further investigation has only accentuated the conviction that the inequalities of this tax make necessary its early repeal. Whatever may be its theoretical merits, in practice it exempts the over-capitalized corporation, falls more heavily upon corporations of small or moderate size than upon the larger corporations, penalizes business conservatism, and places upon the Bureau of Internal Revenue tasks which are beyond its strength. The fact that the excess-profits tax bears less severely upon large than upon small corporations is well illustrated in Table A. This table is based upon the latest Treasury statistics which have been analyzed in detail and covers all the corporations of the country which made full returns of invested capital in the year 1919. The weakness of the excess-profits tax revealed in this table is alone sufficient to condemn it.

TABLE A.—Table showing average rate of excess-profits and income taxes upon corporations of different size.

[Average size of corporations (measured by invested capital) earning different rates of profit; corporation returns made in 1919.]

Per cent of net income to invested capital.	Number of corporations.	Invested capital.	Average invested capital.	Per cent of income and profits tax to net income.
Less than 5 per cent.....	10,689	\$14,104,248,246	\$1,319,511	10.99
5 to 10 per cent.....	21,869	15,925,632,944	728,229	11.93
10 to 15 per cent.....	22,681	8,962,689,034	395,111	21.60
15 to 20 per cent.....	17,388	5,482,627,463	315,311	33.99
20 to 25 per cent.....	11,987	3,251,948,260	271,290	41.51
25 to 30 per cent.....	7,743	3,785,581,785	488,904	51.22
30 to 40 per cent.....	9,050	2,421,285,621	267,545	53.38
40 to 50 per cent.....	4,807	1,232,173,122	256,329	57.58
50 to 75 per cent.....	4,911	784,254,745	159,693	62.30
75 to 100 per cent.....	1,734	205,744,478	118,653	64.24
100 per cent and over.....	2,194	133,853,470	61,009	67.40
Total.....	115,056	50,290,039,168	489,240	37.86

#### REDUCTION OF SURTAXES.

Your committee recommends a reduction of the maximum surtax from 65 per cent to 32 per cent in the belief that in the near future the lower surtax will, by stimulating sales and profit taking, and by making possible transactions now blocked by excessive surtax rates, not only facilitate needed business readjustments but actually increase the revenue. In the long

run in the opinion of your committee the 32 per cent rate will yield more revenue than the 65 per cent rate. The effect of excessive surtaxes in forcing the investment of capital in tax-free securities and in encouraging taxpayers to avoid the tax through the device of gifts, division of their income, refraining from profitable sales, and placing their money in investments which promise well for the future but yield no immediate return, is clearly brought out in Table B following, which shows the decline in incomes over \$300,000 from the year 1916 to the year 1919. During this period the number of taxpayers and the amount of net income returned by the general body of taxpayers greatly increased. But this was not true of the wealthier classes.

The number of returns of incomes over \$300,000 fell from 1,296 in 1916 to 679 in 1919; the net income reported by these taxpayers fell from \$992,972,986 in 1916 to \$440,011,589 in 1919; and the taxable income of these taxpayers from dividends, interest, and investment fell during the same period from \$706,945,738 to \$314,984,884. This shrinkage of income among taxpayers having a net income of over \$300,000 represents not declining prosperity or shrinkage of actual income but the result of excessive surtaxes. There was no such decline in actual income, but principally a reduction of taxable income.

TABLE B.—Table showing decline of incomes over \$300,000.

	Number of returns.		Net income.		Income from dividends, interest, and investments.	
	All classes.	Incomes over \$300,000.	All classes.	Incomes over \$300,000.	All classes.	Incomes over \$300,000.
1916.....	437,036	1,296	\$6,298,577,620	\$992,972,986	\$3,217,348,030	\$706,945,738
1917.....	3,472,890	1,015	13,652,383,207	731,372,153	3,785,557,955	616,119,892
1918.....	4,425,114	627	15,921,639,355	401,107,868	3,872,231,935	314,111,461
1919.....	5,332,760	679	19,859,491,448	440,011,589	3,954,553,925	314,984,884

TABLE II.—Estimated revenue collections during the fiscal year ending June 30, 1921, under the revenue act of 1918 and during the fiscal years 1922 and 1923 under the existing law and under H. R. 8245 as it passed the House and as reported to the Senate.

Source of revenue.	Revenue collected during the fiscal year 1921.	Revenue collections during the fiscal years—					
		1922			1923		
		Present law.	House bill.	Bill as reported to the Senate.	Present law.	House bill.	Bill as reported to the Senate.
<b>Income tax:</b>							
Individual.....	} \$3,225,790,653	\$900,000,000	\$850,000,000	\$850,000,000	\$840,000,000	\$765,000,000	\$750,000,000
Corporation.....		430,000,000	430,000,000	430,000,000	415,000,000	480,000,000	540,000,000
Profits tax.....		600,000,000	600,000,000	600,000,000	460,000,000	150,000,000	150,000,000
Back taxes.....		230,000,000	230,000,000	230,000,000	300,000,000	300,000,000	300,000,000
Miscellaneous internal-revenue taxes.....	1,369,210,112	1,300,000,000	1,130,000,000	1,216,600,000	1,325,000,000	965,330,000	1,000,480,000
<b>Total.....</b>	<b>4,595,000,765</b>	<b>3,460,000,000</b>	<b>3,240,000,000</b>	<b>3,326,600,000</b>	<b>3,340,000,000</b>	<b>2,660,330,000</b>	<b>2,740,400,000</b>

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TABLE III.—Revenue collections during the fiscal year 1921 under the revenue act of 1918 and estimated revenue collections under H. R. 8245 as reported to the Senate for the fiscal years 1922 and 1923 and for the calendar year 1923.

Source of revenue.	Collections, fiscal year 1921.	Estimated collections.		
		Fiscal year 1922.	1923	
			Fiscal year.	Calendar year.
<b>Income tax:</b>				
Individual.....	13,225,790,653	\$830,000,000	\$780,000,000	\$780,000,000
Corporation.....		430,000,000	540,000,000	668,000,000
Profits tax.....		600,000,000	150,000,000	.....
Back taxes.....		230,000,000	300,000,000	328,000,000
Miscellaneous internal revenue.....	1,369,210,112	1,216,600,000	1,000,400,000	945,808,000
<b>Total.....</b>	<b>4,595,000,765</b>	<b>3,326,600,000</b>	<b>2,740,400,000</b>	<b>2,655,808,000</b>
<b>Estate tax.....</b>	<b>154,099,908</b>	<b>150,000,000</b>	<b>150,000,000</b>	<b>150,000,000</b>
<b>Transportation:</b>				
Freight, passengers, seats, berths, staterooms.....	245,965,999	170,000,000	60,000,000	.....
Express and oil by pipe lines.....	27,083,809	25,000,000	25,000,000	25,000,000
Telegraph and telephone.....	28,442,375	27,000,000	27,000,000	27,000,000
Insurance.....	18,992,094	10,000,000	.....	.....
Alcoholic spirits, etc.....	82,622,316	75,000,000	75,000,000	75,000,000
Nonalcoholic beverages.....	.....	16,000,000	18,000,000	20,000,000
Cereal beverages, soft drinks, fruit juices, fountain sirups, table waters, etc.....	58,673,192	24,000,000	14,000,000	14,000,000
Carbonic acid gas.....	.....	1,000,000	2,000,000	2,000,000
Tobacco.....	253,990,017	250,000,000	250,000,000	250,000,000
Admissions and dues.....	95,882,345	95,000,000	90,000,000	90,000,000
Automobiles, trucks, parts, etc.....	115,545,760	110,000,000	110,000,000	110,000,000
Musical instruments, etc.....	11,567,931	12,000,000	12,000,000	12,000,000
Sporting goods, etc.....	4,283,872	3,000,000	2,000,000	2,000,000
Chewing gum.....	1,332,177	1,000,000	1,000,000	1,000,000
Cameras, etc. (901-906).....	849,940	800,000	800,000	800,000
Photographic films, etc.....	7,053,538	6,000,000	6,000,000	6,500,000
Candy.....	20,436,478	18,000,000	19,000,000	20,000,000
Firearms, knives, etc.....	3,738,942	3,500,000	3,500,000	3,500,000
Electric fans.....	297,583	300,000	300,000	300,000
Thermos bottles, cigar or cigarette holders, pipes, etc., automatic slot vending machines, liveries, etc., hunting and shooting garments.....	761,618	800,000	800,000	800,000
Fur articles.....	9,081,239	9,000,000	9,000,000	9,000,000
Yachts and motor boats.....	553,202	500,000,000	500,000,000	500,000,000
Toilet soaps, etc.....	2,223,774	2,000,000	2,000,000	2,000,000
Art works.....	1,116,337	1,000,000	800,000	800,000
Luxuries.....	20,374,591	10,000,000	3,000,000	4,000,000
Jewelry, etc.....	24,303,906	24,000,000	24,000,000	25,000,000
Perfumes, cosmetics.....	.....	4,500,000	6,000,000	6,000,000
Proprietary medicines.....	5,800,768	1,500,000	.....	.....
Corporation capital stock.....	81,514,345	75,000,000	.....	.....
<b>Stamp taxes:</b>				
Issues and conveyances, stocks, bonds, etc.....	53,551,461	55,000,000	55,000,000	55,000,000
Capital stock transfers.....	8,790,905	8,000,000	6,000,000	6,000,000
Safe produce, exchange.....	7,521,675	7,500,000	7,500,000	7,500,000
Miscellaneous taxes.....	22,767,110	20,200,000	20,200,000	20,200,000
<b>Total miscellaneous taxes.....</b>	<b>1,369,179,122</b>	<b>1,216,600,000</b>	<b>1,000,400,000</b>	<b>945,808,000</b>

TABLE IV.—Income tax revenue upon specified incomes under existing law and under H. R. 8245, as passed by the House and as reported to the Senate.

[Tax computed on the basis of the net income of a married man without dependents.]

Income.	Present law.			House bill H. R. 8245.						
	Normal.	Surtax.	Total.	As passed by House.			As reported to the Senate.			
				Normal.	Surtax.	Total.	Normal.	Surtax.	Total.	
\$2,000										
2,500	\$20		\$20	\$20		\$20	\$20			\$20
3,000	20		20							
3,000	40		40	40		40	40			40
3,000	40		40	20		20	20			20
4,000	80		80	80		80	80			80
4,000	80		80	60		60	60			60
5,000	120		120	120		120	120			120
5,000	120		120	100		100	100			100
6,000	160	\$10	170	160	\$10	170	160			160
8,000	320	50	370	320	50	370	320	\$20		340
10,000	480	110	590	480	110	590	480	60		540
12,000	640	190	830	640	190	830	640	120		760
14,000	800	290	1,090	800	290	1,090	800	200		1,000
16,000	960	410	1,370	960	410	1,370	960	300		1,260
18,000	1,120	550	1,670	1,120	550	1,670	1,120	420		1,540
20,000	1,280	710	1,990	1,280	710	1,990	1,280	560		1,840
25,000	1,680	1,200	2,880	1,680	1,200	2,880	1,680	1,100		2,780
30,000	2,080	1,810	3,890	2,080	1,810	3,890	2,080	1,760		3,840
40,000	2,880	3,410	6,290	2,880	3,410	6,290	2,880	3,400		6,280
50,000	3,680	5,510	9,190	3,680	5,510	9,190	3,680	5,500		9,180
75,000	5,680	12,950	18,630	5,680	12,790	18,470	5,680	12,780		18,460
100,000	7,680	23,510	31,190	7,680	20,790	28,470	7,680	20,780		28,460
150,000	11,680	49,510	61,190	11,680	36,790	48,470	11,680	36,780		48,460
200,000	15,680	77,510	93,190	15,680	52,790	68,470	15,680	52,780		68,460
300,000	23,680	137,510	161,190	23,680	84,790	108,470	23,680	84,780		108,460
500,000	39,680	263,510	303,190	39,680	148,790	188,470	39,680	148,780		188,460
1,000,000	79,680	583,510	663,190	79,680	308,790	388,470	79,680	308,780		388,460
2,000,000	159,680	1,233,510	1,393,190	159,680	628,790	788,470	159,680	628,780		788,460
3,000,000	239,680	1,883,510	2,123,190	239,680	948,790	1,188,470	239,680	948,780		1,188,460
5,000,000	399,680	3,183,510	3,583,190	399,680	1,588,790	1,988,470	399,680	1,588,780		1,988,460

¹ Net income not in excess of \$5,000.

## THE BILL.

The bill is divided into 14 titles, as follows:

Title I. General definitions.

Title II. Income tax.

Title III. War-profits and excess-profits tax for 1921.

Title IV. Estate tax.

Title V. Tax on transportation and other facilities.

Title VI. Tax on soft drinks and constituent parts thereof.

Title VII. Tax on cigars, tobacco, and manufactures thereof.

Title VIII. Tax on admissions and dues.

Title IX. Excise taxes.

Title X. Special taxes.

Title XI. Stamp taxes.

Title XII. Tax on employment of child labor.

Title XIII. General administrative provisions.

Title XIV. General provisions.

## TITLE I.—GENERAL DEFINITIONS.

This title contains definitions applicable to the entire bill. The following terms are defined in this title: Revenue act of 1921, person,



corporation, domestic, foreign, United States, Secretary, commissioner, collector, taxpayer, military or naval forces of the United States, and Government contract. This title provides that this act may be cited as the "Revenue act of 1921." All the other terms specified in this title are defined in the same manner as under the revenue act of 1918.

## TITLE II.—INCOME TAX.

### DEFINITIONS.

Section 200 adds to the definitions contained in the revenue act of 1918 two new terms—"foreign trader" and "foreign trade corporation"—defined to mean, respectively, a citizen or resident of the United States (or a partnership) and a corporation, more than 80 per cent of whose gross income for the three-year period ending with the close of the taxable year (or for such part of such period as may be applicable) was derived from sources without the United States, and which derive 50 per cent or more of their gross income for such period from the active conduct of a trade or business without the United States. These amendments constitute part of a general plan (more fully described in section 217) to tax American business concerns whose business is practically all conducted in foreign countries only on their income derived from sources within the United States. A domestic corporation or citizen who derives 80 per cent of his income from foreign investments will not be entitled to treatment as a foreign trade corporation or foreign trader, since the plan is confined to business concerns, but salaried men living and working abroad complying with the other conditions will be classed as foreign traders.

Under existing law an American citizen or domestic corporation is taxed upon his or its entire income, even though all of it is derived from business transacted without the United States. This results in double taxation, places American business concerns at a serious disadvantage in the competitive struggle for foreign trade, encourages American corporations doing business in foreign countries to surrender their American charters and incorporate under the laws of foreign countries, results in serious administrative difficulties with respect to the collection of taxes due from individuals resident in foreign countries, and encourages American citizens to expatriate themselves. In order to remedy this situation foreign traders and foreign trade corporations, as above defined, will be taxed under this act substantially as nonresidents—i. e., only on income derived from sources within the United States.

### DIVIDENDS.

Section 201 clarifies the definition of dividends as contained in the revenue act of 1918, by omitting or exempting stock dividends as required by the decision of the Supreme Court in *Eisner v. Macomber* (252 U. S., 189), and provides a general rule for distributions in liquidation and all distributions otherwise than out of earnings accumulated since February 28, 1913. The rule is that such distributions shall be treated as a partial or full return of cost to the distributee of his stock or shares, and if the stockholder receives more than the cost price of his stock, he is taxable under section

202 with respect to the excess in the same manner as though such stock had been sold. Section 202 protects the stockholder who acquired his stock before March 1, 1913, by providing that gains accrued between the date of acquisition and March 1, 1913, shall not, when the property is sold or liquidated, be included in the taxable income.

Minor obscurities in the present law have been clarified by stating conclusively certain provisions which heretofore have been stated as presumptions. It is further provided that a taxable distribution shall be included in the gross income of the distributees as of the date when the cash or other property is unqualifiedly made subject to their demands, which is in accord with the decisions of the courts and is well established in departmental practice.

#### BASIS FOR DETERMINING GAIN OR LOSS.

Section 202 provides in detailed form for the basis (used in the case of the sale or other disposition of property) for determining gain or loss. Because of the decisions of the Supreme Court in the case of *Goodrich v. Edwards* and *Walsh v. Brewster* (decided Mar. 28, 1921), it is necessary to state explicitly in the statute the method of treating gain or loss accrued prior to March 1, 1913. Heretofore property held on March 1, 1913, has been considered capital as of its value on that date. The concession of the Solicitor General in the above cases, adopted by the court, is to the effect that gain or loss in every case is determined upon the basis of cost or acquisition value and not by the March 1 value of the property, the gain or loss accruing before March 1, 1913, however, being excluded for purposes of computing the net income subject to tax.

The proposed act provides that in the case of property acquired before March 1, 1913, and sold or disposed of after that date, (1) if its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income is the excess of the amount realized therefor over such fair market price or value; (2) if its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of that date over the amount realized therefor; and (3) if the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain or loss is recognized.

The above provision states only the general rule. The special rules embodied in existing law with respect to property which should be included in the inventory, and property acquired by bequest, devise, or inheritance are in substance preserved. An essential change, however, is made in the case of property acquired by gift. No explicit rule is found in the present statute for determining gain or loss resulting from the sale of such property, but the Treasury Department has held that the proper basis for such determination is the fair market price or value of such property at the time of its acquisition by the donee. This rule has been the source of serious abuse. Taxpayers who have property the value of which has increased, give such property to wives or relatives, by whom it may be sold without taxation of the increase in value which took place while the property was owned by the donor. The proposed bill, in

paragraph (2) of subdivision (a), provides a new and just rule, namely, that in the case of property acquired by gift after December 31, 1920, the basis for computing gain or loss is the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. This means that if the property cost the donor \$50, and at the time it was given to the donee it was worth \$100, for which amount it is sold by the donee, the income of the donee would be \$50 instead of nothing, as under the present law. If the facts necessary to determine the cost are unknown to the donee, the commissioner is empowered to obtain the facts from the donor or any other person, or, if it is found impossible to obtain such facts, to appraise the value of such property as of the time it was acquired by such donor or last preceding owner. This paragraph does not apply to gifts made in contemplation of death or to gifts made to take effect in possession and enjoyment at or after death, but such testamentary gifts are to be treated as bequests or devises.

Subdivision (c) of this section of the House bill, which provided that, in ascertaining gain or loss from the sale or other disposition of property, proper adjustments should be made for capital expenditures or for loss, depreciation, etc., was stricken out by your committee on the ground that it specified a self-evident rule and was thus superfluous.

#### EXCHANGES OF PROPERTY FOR PROPERTY.

Section 202 (subdivision c) provides new rules for those exchanges or "trades" in which, although a technical "gain" may be realized under the present law, the taxpayer actually realizes no cash profit.

Under existing law "when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any \* \* \*." Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value. These classes comprise the cases where productive property (other than stock in trade or property held primarily for sale) used in a trade or business is exchanged for property of a like kind or use; where in any corporate reorganization or readjustment stock or securities are exchanged for stock or securities of a corporation which is a party to or results from such reorganization; and where an individual or individuals transfer property to a corporation and after such transfer are in control of such corporation.

The preceding amendments, if adopted, will, by removing a source of grave uncertainty and by eliminating many technical constructions which are economically unsound, not only permit business to go forward with the readjustments required by existing conditions but also will considerably increase the revenue by preventing taxpayers

from taking colorable losses in wash sales and other fictitious exchanges.

Proper safeguards are found in subdivision (d), which provides that where property is exchanged for other property or where property is involuntarily converted into cash and the proceeds of such conversion are used to replace the property converted, or where a wash sale is not recognized, the property received in exchange shall be treated as taking the place of the original property.

#### INVENTORIES.

Section 203, relating to inventories, is the same as the inventory section of existing law.

#### NET LOSSES.

Section 204: Under existing law a business operated at a loss for any year can take no credit or deduction for that loss against any profit which may be earned in succeeding years. The revenue act of 1918 authorized a deduction for net losses beginning after October 31, 1918, and ending prior to January 1, 1920, but its provisions did not extend past the latter date. The present act proposes to revive the net loss allowance in modified form by providing that if for any taxable year beginning after December 31, 1920, it appears upon the presentation of evidence satisfactory to the commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year.

Taxpayers having a fiscal year beginning in 1920 and ending in 1921 will be entitled to deduct the same proportion of any net loss sustained in such year, which the portion of such fiscal year falling within the calendar year 1921 is of the entire fiscal year.

#### FISCAL YEAR METHOD OF COMPUTING INCOME TAX.

Section 205 retains the present method of computing income taxes in the case of taxpayers making returns upon the fiscal year basis. The only changes made in existing law are of a clerical nature to make the provision apply to returns for the fiscal years 1921 and 1922.

#### CAPITAL GAIN AND CAPITAL LOSS.

Section 206 limits the rate of taxation upon gain derived from the sale of capital assets. Under the present law many sales of farms, mineral properties, and other capital assets have been prevented by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum and the amount of surtax excessively enhanced thereby. In order to permit such transactions to take place without fear of prohibitive tax, section 206 provides that only 40 per cent of the net gain derived from the sale or other disposition of capital assets shall be taken into account in determining the net income upon which the income tax is imposed. This automatically reduces the rate of taxes applicable to such income by 60 per cent. The maximum rate (normal and surtax) upon ordinary

income after January 1, 1922, will be 40 per cent, and the maximum rate applicable to capital net gain will be 16 per cent. The House bill placed a similar limitation upon both capital gains and losses, but this limitation was not applicable to corporations nor to certain classes of taxpayers having net income less than \$29,000. The Senate provision would permit a taxpayer to deduct the entire loss sustained in a capital transaction and is applicable to all classes of taxpayers. In Great Britain capital gain or loss is ignored or eliminated in computing the net income. Section 206 takes an intermediate position between the extreme views embodied, respectively, in the present American and British laws.

## PART II.—INDIVIDUALS.

## NORMAL TAX.

Section 210 imposes the same normal tax upon the net income of citizens or residents of the United States as that imposed under existing law. The tax imposed under existing law is 4 per cent upon the first \$4,000 of net income in excess of the credits provided under section 216, and 8 per cent upon the remainder of the taxpayer's net income.

## SURTAX.

Section 211: The following table shows the surtaxes levied under existing law and under the proposed bill as it passed the House and as reported to the Senate:

Income.	Surtax rates under—			Income.	Surtax rates under—		
	Exist- ing law.	Proposed bill.			Exist- ing law.	Proposed bill.	
		As it passed House.	As re- ported to the Senate.			As it passed House.	As re- ported to the Senate.
	Per ct.	Per ct.	Per ct.		Per ct.	Per ct.	Per ct.
\$5,000 to \$6,000.....	1	1	1	\$58,000 to \$60,000.....	28	28	28
\$6,000 to \$8,000.....	2	2	1	\$60,000 to \$62,000.....	29	29	29
\$8,000 to \$10,000.....	3	3	2	\$62,000 to \$64,000.....	30	30	30
\$10,000 to \$12,000.....	4	4	3	\$64,000 to \$66,000.....	31	31	31
\$12,000 to \$14,000.....	5	5	4	\$66,000 to \$68,000.....	32	32	32
\$14,000 to \$16,000.....	6	6	5	\$68,000 to \$70,000.....	33	32	32
\$16,000 to \$18,000.....	7	7	6	\$70,000 to \$72,000.....	34	32	32
\$18,000 to \$20,000.....	8	8	7	\$72,000 to \$74,000.....	35	32	32
\$20,000 to \$22,000.....	9	9	10	\$74,000 to \$76,000.....	36	32	32
\$22,000 to \$24,000.....	10	10	11	\$76,000 to \$78,000.....	37	32	32
\$24,000 to \$26,000.....	11	11	12	\$78,000 to \$80,000.....	38	32	32
\$26,000 to \$28,000.....	12	12	13	\$80,000 to \$82,000.....	39	32	32
\$28,000 to \$30,000.....	13	13	14	\$82,000 to \$84,000.....	40	32	32
\$30,000 to \$32,000.....	14	14	15	\$84,000 to \$86,000.....	41	32	32
\$32,000 to \$34,000.....	15	15	16	\$86,000 to \$88,000.....	42	32	32
\$34,000 to \$36,000.....	16	16	16	\$88,000 to \$90,000.....	43	32	32
\$36,000 to \$38,000.....	17	17	17	\$90,000 to \$92,000.....	44	32	32
\$38,000 to \$40,000.....	18	18	18	\$92,000 to \$94,000.....	45	32	32
\$40,000 to \$42,000.....	19	19	19	\$94,000 to \$96,000.....	46	32	32
\$42,000 to \$44,000.....	20	20	20	\$96,000 to \$98,000.....	47	32	32
\$44,000 to \$46,000.....	21	21	21	\$98,000 to \$100,000.....	48	32	32
\$46,000 to \$48,000.....	22	22	22	\$100,000 to \$150,000.....	52	32	32
\$48,000 to \$50,000.....	23	23	23	\$150,000 to \$200,000.....	56	32	32
\$50,000 to \$52,000.....	24	24	24	\$200,000 to \$300,000.....	60	32	32
\$52,000 to \$54,000.....	25	25	25	\$300,000 to \$500,000.....	63	32	32
\$54,000 to \$56,000.....	26	26	26	\$500,000 to \$1,000,000.....	64	32	32
\$56,000 to \$58,000.....	27	27	27	\$1,000,000 and over.....	65	32	32

## NET INCOME DEFINED.

Section 212 defines net income to mean the gross income as defined in section 213 less the deductions allowed by section 214. This section is the same as the like section of the revenue act of 1918.

## GROSS INCOME DEFINED.

Section 213 defines gross income in the same manner as gross income is defined in existing law with important amendments. Under an opinion of the Attorney General, residents of States having a community property law enjoyed marked advantage over the residents of other States. Income which in other States is taxed as a unit to the husband is divided between husband and wife in States having community property laws, and the surtaxes are correspondingly reduced. An amendment is added to this section designed to restore uniformity of treatment, by providing that income received by any marital community shall be included in the gross income of the spouse having the management and control of the community property, and shall be taxed as the income of such spouse.

Interest on postal savings certificates of deposit, United States pensions for war service, and amounts received as compensation or allowances under the provisions of the war risk insurance and the vocational rehabilitation acts are exempted from taxation by this section. In order to encourage the international adoption of uniform tax laws affecting shipping companies, for the purpose of eliminating double taxation, paragraph 8 of subdivision (a) of this section exempts foreign shipping companies more than 95 per cent of whose gross income consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States or to domestic corporations, from taxation upon such shipping earnings.

## DEDUCTIONS ALLOWED INDIVIDUALS.

Section 214 allows substantially the same deductions in computing net income as are authorized under existing law, but adds the following provisions: (1) The deduction for business expenses is extended to include all traveling expenses incurred while away from home in the pursuit of a trade or business; (2) under existing law a taxpayer is permitted to deduct interest paid upon money borrowed to purchase or carry tax-free Liberty bonds or Victory notes. The interest deduction is amended so that such interest accrued or paid after January 1, 1922, shall not be deducted; (3) to prevent evasion through the medium of wash sales, it is provided that no deduction shall be allowed for losses sustained in the sale of securities where it appears that within 30 days after such sale the taxpayer purchases identical securities; (4) losses occurring in one year are frequently not determined or sustained until another year, depending upon court decision or the clearing up of uncertainty. To permit more elastic treatment of such losses, in the interests of justice to the taxpayer, it is provided that certain losses shall not be deducted as of the taxable year in which sustained, if in the opinion of the

commissioner they should be accounted for as of a different period; (5) the doctrine enunciated in the cases of *Goodrich v. Edwards* and *Walsh v. Brewster* (decided Mar. 28, 1921) gives ground for the belief that under existing law the depreciation deduction should be computed on the basis of cost in the case of property acquired prior to March 1, 1913. In order to remove all doubt in the future it is here provided that in the case of property acquired prior to March 1, 1913, the depreciation deduction shall be computed upon the basis of the fair market price or value of the property as of that date; (6) in order to make it certain that the depletion deduction when based upon discovery value shall not be permitted to offset or cancel profits derived by the taxpayer from a separate and distinct line of business, it is provided that the depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or the fair market value as of March 1, 1913; and (7) an additional subdivision has been added which provides that when property is involuntarily converted into cash as a result of fire, shipwreck, condemnation, or related causes the taxpayer may deduct the gains involuntarily realized (or a proper part thereof) when he proceeds forthwith in good faith to invest the proceeds (or a part thereof) of such conversion in the acquisition of similar property or in the establishment of a replacement fund therefor.

#### ITEMS NOT DEDUCTIBLE.

Section 215 specifies certain items that are not deductible in computing net income. Under existing law persons receiving by gift, bequest, or inheritance a life or other terminable interest in property frequently capitalize the expected future income, set up the value of this expectation as corpus or principal, and thereafter claim a deduction for exhaustion of this so-called principal on the ground that with the passage of time the "principal" or corpus is gradually shrinking or wasting. A new subdivision has been added to this section explicitly providing that no such deduction shall be recognized.

#### CREDITS ALLOWED INDIVIDUALS.

Section 216 specifies the credits allowed in computing the normal tax only. Under existing law single persons receive an exemption of \$1,000, and each head of a family \$2,000, with an additional allowance of \$200 for each dependent. Under the proposed bill the allowance for each dependent is raised to \$400; and each head of a family will receive a personal exemption of \$2,500 unless the net income is in excess of \$5,000 (aggregate income of husband and wife in case of married persons living together), in which case the personal exemption is only \$2,000.

Under existing law nonresident alien individuals are allowed the same personal exemptions as citizens or residents if the country in which the nonresident alien resides allows the same credit to citizens of the United States. The present exemption for nonresident aliens has been found very difficult of administration and an amendment is

proposed allowing nonresident aliens only a single personal exemption of \$1,000.

#### NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN TRADERS.

Section 217 states explicit rules—applicable principally to nonresident aliens and foreign traders—for computing the net income derived from sources within the United States. The present law is both obscure and economically unsound, inasmuch as the Attorney General has held that where goods are manufactured or produced in the United States and sold abroad, no part of the profit is derived from a source within the United States. This section explicitly allocates certain important sources of income to the United States or to foreign countries, as the case may be, and with respect to the remaining income (particularly that derived partly from sources within and partly from sources without the United States) authorizes the commissioner, with the approval of the Secretary, to determine the income derived from sources within the United States either by rules of separate allocation or by processes or formulas of general apportionment.

#### PARTNERSHIPS AND PERSONAL-SERVICE CORPORATIONS.

Section 218 is the same as the corresponding provision in existing law except that proper provision is made for the repeal, as of January 1, 1922, of the tax on the stockholders of a personal-service corporation with respect to undistributed profits in such corporation and the taxation of such corporation in the same manner as other corporations are taxed.

#### ESTATES AND TRUSTS.

Section 219 is amended slightly for the purpose of clarifying its provisions and making the interpretation thereof more definite and certain. A new subdivision (f) is added providing that an irrevocable trust created by an employer as a part of a stock bonus or profit-sharing plan shall not be taxable under this section, but that the amounts actually distributed to any employee shall be taxable to the employee when distributed, to the extent that they exceed the contributions made by such employee.

#### EVASION OF SURTAXES BY INCORPORATION.

Section 220 of the existing law provides that if any corporation is formed or availed of for the purpose of evading the surtax upon its stockholders, through the medium of permitting its gain and profits to accumulate instead of being divided, the stockholders shall be taxed in the same manner as partners. By reason of the recent decision of the Supreme Court in the stock-dividend case (*Eisner v. Macomber*, 252 U. S., 189), considerable doubt exists as to the constitutionality of this provision of existing law. Section 220 of the bill therefore proposes to amend section 220 of the existing law so as to impose upon corporations of the character above described a flat additional income tax of 25 per cent; but, if the stockholders agree,



they may be taxed upon their distributive shares in the net income of the corporation in the same manner as members of a partnership, such taxes to be in lieu of all income taxes upon the corporation.

#### PAYMENT OF INDIVIDUAL'S TAX AT SOURCE.

Section 221 is amended to provide that the income of partnerships composed in whole or in part of nonresident aliens shall be withheld at the source.

#### CREDIT FOR TAXES IN CASE OF INDIVIDUALS.

Section 222: The income tax law allows a credit, dollar for dollar, against our tax for any income or profits taxes paid to any foreign country or to any possession of the United States, with certain modifications in the case of alien residents of the United States. Where foreign income or profits taxes are imposed at rates higher than those carried by the similar taxes in this country, this credit may wipe out part of our tax properly attributable to income derived from sources within the United States. To prevent this abuse, section 222 provides that in no case shall the amount of this credit exceed the same proportion of our tax which the taxpayer's net income from sources without the United States bears to his entire net income. This credit is not allowed to foreign traders.

#### INDIVIDUAL RETURNS.

Section 223: Under existing law every single person having a net income for the taxable year of \$1,000, or over, and every married person living with husband or wife having a net income of \$2,000, or over, is required to make an income-tax return. Your committee proposes an additional provision requiring every individual having a gross income of \$5,000 or more to make an income-tax return regardless of the amount of his net income. It also is made clear that husband and wife may make a joint return even though one or both have incomes large enough to be subject to surtaxes.

#### PARTNERSHIP RETURNS.

Section 224 is reenacted in the same form as it exists in the revenue act of 1918.

#### FIDUCIARY RETURNS.

Section 225 is amended in order that the provisions relating to the filing of fiduciary returns may correspond to the provisions of section 223 relating to the filing of individual returns.

#### RETURNS WHEN ACCOUNTING PERIOD CHANGES.

Section 226 of the present law is reenacted with unimportant changes, and the addition of a new subdivision (c) providing that in the case of returns for a period of less than one year, the net income shall be placed on an annual basis, and the tax shall be the

same part of a tax computed on such annual basis as the number of month in such period is of 12 months.

TIME AND PLACE FOR FILING INDIVIDUAL, PARTNERSHIP, AND FIDUCIARY  
RETURNS.

Section 227 is amended by extending from three to six months the time for the filing of returns by nonresident alien individuals. This amendment is designed to encourage nonresident aliens to file accurate returns.

UNDERSTATEMENT IN RETURNS.

Section 228 is reenacted as found in the revenue act of 1918.

PART III.—CORPORATIONS.

TAX ON CORPORATIONS.

Section 230 provides that the corporation tax for the calendar year 1921 shall be 10 per cent of the corporate net income and that for the calendar year 1922 and each year thereafter the rate shall be increased to 15 per cent. The rate under existing law is 10 per cent. The proposed increase to 15 per cent is imposed as a substitute for the excess-profits tax, which is repealed as of January 1, 1922, and for the capital stock tax, which is repealed as of July 1, 1922. The repeal of the excess-profits tax involves an annual revenue reduction of \$400,000,000, and the repeal of the capital stock tax an annual reduction of \$75,000,000. The additional tax of 5 per cent upon corporations will increase the revenue \$260,000,000 per year.

CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

Section 231 specifies the classes of corporations which are exempt. It makes the following changes in existing law: (1) Domestic building and loan associations will, under the proposed law, be exempt only in case substantially all of their business is confined to making loans to members; (2) community chests, funds or foundations, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, are included within the terms of the exemption applicable to corporations, none of the net earnings of which inure to the benefit of any private stockholder or individual; (3) the exemption granted to farmers' fruit-growers', or like associations organized and operated as sales agents for the purpose of marketing products, is extended to like associations acting as purchasing agents for the purpose of purchasing supplies and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expense.

NET INCOME OF CORPORATIONS DEFINED.

Section 232 is the same as the corresponding section in the revenue act of 1918.

## GROSS INCOME OF CORPORATIONS DEFINED.

Section 233 is slightly amended in order to provide for the determination of the gross income of foreign traders and foreign-trade corporations and to exclude life insurance companies, for the taxation of which special provisions are made in sections 242 to 246, inclusive.

## DEDUCTIONS ALLOWED CORPORATIONS.

Section 234 authorizes corporations to take deductions similar to those accorded individuals by the terms of section 214, with the following provisions applicable only to corporations: (1) Corporations (particularly banks) are permitted to deduct certain taxes paid by them for or on behalf of their shareholders or members; (2) where an obligor is required to withhold a tax under a tax-free covenant bond, the obligee is authorized to omit or exclude such tax from his gross income; (3) and dividends received from a foreign corporation are deductible only when it is shown that more than 50 per cent of the gross income of such foreign corporation was derived from sources within the United States. This dividend deduction is similar to that granted as a credit to individuals for the purposes of computing normal tax in section 216.

## ITEMS NOT DEDUCTIBLE BY A CORPORATION.

Section 235 is the same as the corresponding section in the revenue act of 1918.

## CREDITS ALLOWED CORPORATIONS.

Section 236 is substantially the same as the corresponding section in the revenue act of 1918.

## PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

Section 237 is the same as the corresponding section of the revenue act of 1918, with proper changes for the proposed increase of the corporation income tax rate to 15 per cent on and after January 1, 1922.

## CREDIT FOR TAXES IN CASE OF CORPORATIONS.

Section 238 grants to corporations substantially the same credits for income and profits taxes paid to foreign countries or possessions of the United States as are granted to individuals by section 222.

## CORPORATION RETURNS.

Section 239 is the same as the corresponding section in the revenue act of 1918.

## CONSOLIDATED RETURNS.

Section 240 would give affiliated corporations an option as to whether they shall file a consolidated return or a separate return (commencing with Jan. 1, 1922), although such corporations would be required to adhere to the election, once made, unless authorized to

change by the Commissioner of Internal Revenue. Under existing law affiliated corporations are required to make consolidated returns. Owing to the complexity of the consolidated return in certain instances, the corporations affected would prefer not to make such consolidated return, although it benefits affiliated corporations when one or more of them sustain a loss. The consolidated return is necessary to prevent evasion under the excess-profits tax, but this necessity will disappear when the excess-profits tax is repealed. A new subdivision is added to this section giving the commissioner power to consolidate the accounts of related trades or businesses owned or controlled by the same interests, for the purpose only of making a correct distribution of gains, profits, income, deductions, or capital, among the related trades or businesses. This is necessary to prevent the arbitrary shifting of profits among related businesses, particularly in the case of subsidiary corporations organized as foreign trade corporations.

#### TIME AND PLACE FOR FILING CORPORATION RETURNS.

Section 241 is the same with one unimportant change as the corresponding section in the revenue act of 1918.

#### TAXES ON LIFE INSURANCE COMPANIES.

Sections 242-246 provide a new plan for the taxation of life insurance companies, substantially similar to the plan embodied in the revenue act of 1918 as first adopted by the Senate. The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would take the place of the present income and excess-profits taxes for the year 1921, and life insurance companies would share with other insurance companies in the repeal in the year 1922 of the capital stock tax and the taxes imposed by section 503. The new tax will yield a larger revenue than the taxes which it is proposed to replace.

#### PART IV.—ADMINISTRATIVE PROVISIONS.

##### PAYMENT OF TAXES.

Section 250 has been amended in certain important respects in order to afford relief to the taxpayer in the case of additional assessments made without complete knowledge of all the facts in the case, to prevent harassment by legal actions more than five years after the filing of a return, to protect those taxpayers who have been assessed additional taxes after an adverse court decision when immediate payment of the back taxes found to be due would result in undue hardship, and to prevent the evasion of taxes by taxpayers who depart from the United States without making proper provision with respect to the payment thereof.

Under existing law, when it is found by the Bureau of Internal Revenue that the amount of taxes paid has not been as much as

should have been paid, the taxpayer is given notice that an additional assessment has been made against him and that he will be required to pay the amount of such assessment within 10 days after notice and demand is made therefor by the collector.

It is now proposed (in subdivision d of section 250) that before any additional assessment is made the taxpayer shall be notified thereof and given a period of not less than 30 days in which to file an appeal and show cause why such contemplated assessment should not be made. Opportunity for hearing shall be given and a final decision thereof shall be made as quickly as practicable. Claims in abatement of assessments will not be entertained if the taxpayer has had proper hearing and a final decision has been rendered. These provisions are designed to give every taxpayer notice of contemplated increase in the assessment, to hasten the work of audit and examination, and to secure promptly a departmental decision in which all questions shall be settled at the same time.

The laws relating to the time within which assessments may be made, suits brought for the collection of taxes, refunds or credits for taxes filed, and court actions instituted for the recovery of taxes illegally or erroneously collected have in the past been uncertain and annoying to taxpayers.

By section 1322 of this bill the time for the making of an assessment increase of taxes other than income, excess-profits, war-profits, or corporation excise taxes under the act of August 5, 1909, has been limited to four years after the tax became due. In section 250(d) the time for assessing income, excess-profits, and war-profits taxes under this bill has been limited to four years, and under prior acts to five years.

Section 1320 of this bill prevents the bringing of any suit or proceeding by the Government in any court for the collection of internal-revenue taxes after the expiration of five years from the time such tax was due, except in the case of fraud. Heretofore, except in the case of income, excess-profits, and war-profits taxes under the revenue act of 1918, there was no limit upon the time in which the Government could bring suit for the collection of taxes. Subdivision (d) of section 250 contains limitations with respect to income and profits taxes similar to those contained in section 1320.

Section 3226 of the Revised Statutes has been amended by section 1318 of this bill to provide that the taxpayer may bring suit to recover taxes at any time within five years after he has paid his tax, provided that he has filed a claim for the refund thereof and has waited six months after the filing of such claim, in case the commissioner has not rejected the claim prior to such time. This provision removes the ambiguity and doubts surrounding section 3227 of the Revised Statutes.

#### RECEIPTS FOR TAXES.

Section 251 is the same as the corresponding section of existing law.

#### REFUNDS.

Section 252 is extended to authorize a refund in any case (regardless of time limitations) in which the invested capital of the taxpayer

is decreased by the Commissioner of Internal Revenue and such decrease is due to the fact that the taxpayer failed to take adequate depreciation or other deductions in previous years. The refund is for the excess taxes paid in such prior years.

With respect to all other taxes it is provided in section 1316 of this bill that claims for refund may be filed within four years after the payment of the tax, instead of within two years, as under existing law.

#### PENALTIES.

Section 253 is the same as the corresponding section in the revenue act of 1918.

#### RETURNS OF PAYMENTS OF DIVIDENDS.

Section 254 is the same as the corresponding section of the revenue act of 1918.

#### RETURNS OF BROKERS.

Section 255 is the same as the corresponding section of the revenue act of 1918.

#### INFORMATION AT SOURCE.

Section 256 reenacts without change the provisions of existing law relative to information at source. The House bill changed this section to authorize the commissioner to require information relative to the payments made at the rate of \$1,000 per year. It is believed that such a provision would impose too great a burden on the various payors and that the requirements of existing law are all that can be reasonably required. It is therefore recommended that the provisions of existing law be retained without change.

#### RETURNS TO BE PUBLIC RECORDS.

Section 257 reenacts without change the corresponding section of the revenue act of 1918.

#### PUBLICATION OF STATISTICS.

Section 258 reenacts without change the corresponding section of the revenue act of 1918.

#### COLLECTION OF FOREIGN ITEMS.

Section 259 reenacts without change the corresponding section of the revenue act of 1918.

#### CITIZENS OF THE UNITED STATES POSSESSIONS.

Section 250 reenacts the provisions of the corresponding section of the revenue act of 1918 and adds a paragraph providing that nothing in this act shall be construed to amend the provisions of the act approved July 12, 1921, relating to the imposition of income taxes in the Virgin Islands of the United States.

## PORTO RICO AND PHILIPPINE ISLANDS.

Section 261 simplifies the form of the corresponding section of the revenue act of 1918 but does not materially alter the substance of existing law relating to the imposition of income taxes in Porto Rico and the Philippine Islands.

## RETROACTIVE EXEMPTION OF INCOME FROM SOURCES WITHIN THE POSSESSIONS OF THE UNITED STATES.

Section 262 is a new provision authorizing a retroactive exemption of income from sources within the possessions of the United States for those persons who could qualify during the years 1918 to 1921, inclusive, as foreign traders or foreign trade corporations in possessions of the United States. It also authorizes a refund for any taxes paid under the revenue act of 1918 in excess of the retroactive tax determined under or with the benefit of this section.

## TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX FOR 1921.

Your committee recommends the repeal of the war-profits and excess-profits tax as of January 1, 1922. The repeal of this tax is recommended because of its inequalities and difficulty of administration and because of the manner in which it discriminates against corporations with small invested capital. Its repeal was recommended by Secretary Glass in his annual report for the fiscal year ending June 30, 1919, and by Secretary Houston in his annual report for the fiscal year ending June 30, 1920.

The Treasury's objections to the excess-profits tax even as a war expedient (in contradistinction to a war-profits tax) have been repeatedly voiced before the committees of the Congress. Still more objectionable is the operation of the excess-profits tax in peace times. It encourages wasteful expenditure, puts a premium on overcapitalization and a penalty on brains, energy, and enterprise, discourages new ventures, and confirms old ventures in their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices, and has been, and will, so long as it is maintained upon the statute books, continue to be, a material factor in the increased cost of living. (Secretary Glass, Annual Report, 1919, pp. 23-24.)

The reasons for the repeal of the excess-profits tax should be convincing even to those who, on grounds of theory or general political philosophy, are in favor of taxes of this nature. The tax does not attain in practice the theoretical end at which it aims. It discriminates against conservatively financed corporations and in favor of those whose capitalization is exaggerated; indeed, many overcapitalized corporations escape with unduly small contributions. It is exceedingly complex in its application and difficult of administration, despite the fact that it is limited to one class of business concerns—corporations. Moreover, it is rapidly losing its productivity. The invested capital of the average corporation, earning profits high enough to subject it to the excess-profits tax, is now estimated to be increasing at the approximate rate of 12 per cent a year, while the income of the average corporation is almost certainly declining at as great a rate. Both movements cut into the productivity of the tax. If the present changes in capital and income continue for some time in the future, as now seems probable, large reduction may be expected in the yield of the excess-profits tax. (Secretary Houston, Annual Report for 1920, pp. 38, 39.)

Secretary Mellon, in his letter of April 30, 1921, to the chairman of the Committee on Ways and Means, takes the same position.

The excess-profits tax is complex and difficult of administration, and is losing its productivity. It is estimated that for the taxable year 1921 it will

yield about \$450,000,000 [\$400,000,000], as against \$2,500,000,000 in profits taxes for the taxable year 1918, \$1,320,000,000 for the taxable year 1919, and \$750,000,000 for the taxable year 1920. In fairness to other taxpayers and in order to protect the revenues, however, the excess-profits tax must be replaced, not merely repealed, and should be replaced by some other tax upon corporate profits. A flat additional tax on corporate income would avoid determination of invested capital, would be simple of administration, and would be roughly adjusted to ability to pay.

The changes made in this title, sections 300 to 338, inclusive, represent merely the elimination of rates applicable to prior years and other provisions which have already expired.

#### TITLE IV.—ESTATE TAX.

Section 400: The corresponding section of the present law exempts from estate tax "the transfer of the net estate of any decedent who has died or may die while serving in the military or naval forces of the United States in the present war or from injuries received or disease contracted while in such service," and provides for the refundment of any tax collected upon such a transfer. In the proposed bill there is both an enlargement and a limitation of the exemption, the refunding provision remaining unchanged. The enlargement consists in extending the exemption to the estates of citizens of the United States dying from injuries received or disease contracted while serving in the military or naval forces of any country while associated with the United States in the prosecution of such war, or prior to the entrance therein of the United States. The limitation consists in confining the exemption to cases where the injuries were received or disease contracted "in line of duty."

Such other changes as have been made in this section are designed to remove obscurities in the existing law by adopting the construction placed by the Bureau of Internal Revenue upon the corresponding section of the present act.

Section 402 (d) removes the uncertainties in the existing law relating to interests held jointly or as tenants in the entirety, and conforms to the construction which has been given this section by the Bureau of Internal Revenue.

Section 403 (a) (1). It has been held by the Attorney General that real estate located outside the United States, belonging to a resident of the United States at the time of his death, is not to be included in determining the value of the gross estate of such decedent for the purposes of the tax imposed by Title II of the revenue act of 1916. (31 Op. Atty. Gen., 287.) This opinion is regarded as applicable also to Title IV of the present law, which authorizes the deduction of "unpaid mortgages." The proposed bill so amends the section as to exclude the right, if any, to deduct mortgages upon, or any indebtedness with respect to, the property of a resident decedent which is located outside the United States.

Section 403 (a) (2) and (b) (2). Paragraph 2 of subdivisions (a) and (b) of the corresponding section of the present act provides for the deduction of an amount equal to the value of any property received by the decedent as a share in the estate of any person whose death occurred within five years prior to that of the decedent, or which can be identified as having been acquired in exchange for property so received, if an estate tax under the revenue acts of 1917



or 1918 was collected from such estate, and if such property is included in the decedent's gross estate.

The proposed bill extends the right of deduction to property so received from a prior decedent whose estate has paid such a tax "under this or any prior act of Congress." The other amendments of this paragraph are designed to prevent a double deduction, in whole or in part, of the value of the property so received or acquired, and to remedy defects and omissions found to exist in the present law.

Section 403 (a) (3) and (b) (3) makes it clear that gifts by decedent during his lifetime for public, religious, charitable, scientific, literary, educational, or other benevolent purposes are not deductible where the value of the property given is not required under the law to be included in his gross estate.

Section 403 (b) (3). Under existing law the proceeds of insurance upon the life of a nonresident decedent, where the insurer is a domestic company, is deemed property within the United States. This has been found to place American insurance companies at a disadvantage in competing with foreign companies, and, in order to remedy this situation, the proposed bill expressly states that such insurance shall not be regarded as property situated in the United States. A like provision is made respecting moneys deposited with any person carrying on a banking business, by or for a nonresident decedent who is not engaged in business in the United States at the time of his death.

It also accords to the estates of American missionaries, dying in the foreign missionary service, the benefit of the \$50,000 specific exemption which extends to the estates of all resident decedents, where the only reason for denying the exemption would arise from an intention on the part of the deceased missionary to permanently remain in such service.

The concluding paragraph of this section provides for a redetermination of the tax where refund is to be made of any excess payment referable to the allowance of deductions authorized under paragraphs (2) and (3) of subdivisions (a) or (b) of the same section.

Section 404: The corresponding section of the present act requires the executor to file a notice with the collector within 60 days after qualifying as such, or after coming into possession of any property of the decedent. In numerous instances executors have made the mistake of regarding the 60-day period as meaning two months, and have in consequence incurred a penalty by reason of a delinquency in filing the required notice. The change here made is to substitute a two months' period, and in other parts of the proposed bill to change to months the times expressed in days in the present law.

The date from which the period begins to run also is made more certain by specifying the date of the decedent's death or that on which the executor qualifies.

Sections 406 and 407 remove any uncertainty as to the date upon which the tax becomes payable by expressly stating in section 406 that the tax shall be due "and payable" one year after the decedent's death.

Other changes made in section 406 and those made in section 407 are designed to remove the difficulties and uncertainties found in the present law with respect to the question whether the tax can, or "can not be determined" when the return is filed. They also sim-

plify the administration of the law, and should be more readily understood by taxpayers.

A new paragraph has been added to section 407 which makes provision for those cases wherein the executor files a complete return and makes written application to the commissioner for a determination of the tax and discharge from further personal liability. In such cases the commissioner, "as soon as possible and in any event within one year after receipt of such application," is required to notify the executor of the amount of tax, and, upon payment thereof, the executor is to be relieved from personal liability for any additional tax thereafter found to be due.

Provision also is made that such discharge shall not operate to release the gross estate from the lien of any additional tax "while the title to such gross estate remains in the heirs, devisees, or distributees thereof; but no part of such gross estate shall be subject to such lien or to any claim or demand for any such tax if the title thereto has passed to a bona fide purchaser for value." These added provisions are designed to remove for the future the criticism and complaint often made in the past that delay in the determination of the tax liability has worked hardship and embarrassment, and that the existence of the lien, actual or potential, has hindered, delayed, or prevented a sale of assets of the estate.

Section 408 removes the uncertainties of the corresponding section of the present law by expressly authorizing the collector to proceed to collect the tax "upon instruction from the commissioner," if it be not paid "on or before the due date thereof."

Section 411: This section is new and incorporates a provision similar to section 252 of the income tax law, but limits the time within which claims for refund may be filed to a period of three years after the payment of an excess amount of tax.

Section 412 clarifies and codifies existing law by including within the provisions of this act the rule as to the taxation of property of an American citizen in China, as stated in the act entitled "An act making appropriation for the Diplomatic and Consular Service for the fiscal year ending June 30, 1921," approved June 4, 1920.

#### TITLE V.—TAX ON TRANSPORTATION AND OTHER FACILITIES.

Section 500 provides for the reduction of the taxes imposed by the revenue act of 1918 upon freight, passenger, and Pullman transportation by one-half as of January 1, 1922, and such taxes are entirely repealed upon January 1, 1923. By section 503 of the revenue act of 1918 taxes were imposed upon the issuance of life insurance policies and upon the premiums paid on other policies. This provision is eliminated from Title V of this act, and by section 1400 the provisions of the revenue act of 1918 in this regard are repealed as of January 1, 1922. The House bill repeals all transportation taxes and the taxes upon issuance of life insurance policies and the premiums of other policies as of January 1, 1922.

#### TITLE VI.—TAX ON SOFT DRINKS AND CONSTITUENT PARTS THEREOF.

Section 600 imposes manufacturers' sales taxes as follows: Two cents per gallon upon cereal beverages; 2 cents per gallon upon unfer-

mented fruit juices intended for consumption as beverages; 2 cents per gallon upon "still" or noncarbonated soft drinks; 10 cents per gallon upon natural or artificial mineral waters;  $7\frac{1}{2}$  cents per gallon upon finished or fountain sirups used in manufacturing or mixing soft drinks; and 5 cents per pound upon carbonic-acid gas.

The House bill imposes similar taxes, except that the rate on cereal beverages is 4 cents per gallon, on still drinks is 3 cents per gallon, and upon finished or fountain sirups is 10 cents per gallon. The reduction in the rate on finished or fountain sirups to  $7\frac{1}{2}$  cents per gallon is recommended by your committee in order to equalize the difference in tax between carbonated and noncarbonated beverages which would result if the higher rate were imposed.

By section 628 of the revenue act of 1918 a tax of 15 per cent is imposed upon the manufacturer's selling price on cereal beverages, and a like tax of 10 per cent is imposed upon the manufacturer's selling price of all other soft drinks except natural mineral or table waters, which are taxable at the rate of 2 cents per gallon if sold at over 10 cents per gallon.

By section 630 of the revenue act of 1918 a tax of 1 cent for each 10 cents or fraction thereof of the amount paid to persons conducting soda fountains, ice-cream parlors, etc., for soft drinks, ice cream, ice-cream soda, etc., is imposed. This tax has proved very difficult to administer and is widely evaded. Your committee recommends the repeal of both sections 628 and 630 of the revenue act of 1918 as of January 1, 1922. Section 600, above described, is designed to cover this field of taxation by imposing a flat gallon tax, instead of a tax based upon the sale price, upon beverages sold by the manufacturer and imposing a flat gallon tax upon constituent elements of beverages or soft drinks which are compounded or mixed by soda-fountain proprietors and the like.

#### TITLE VII.—TAX ON CIGARS, TOBACCO, AND MANUFACTURERS THEREOF.

This title reenacts without substantial change the provisions of sections 700, 701, 703, and 704 of the revenue act of 1918. Section 702 of that act is not reenacted. Sections 703 and 704 of the revenue act of 1918 therefore become sections 702 and 703, respectively, of the present bill.

#### TITLE VIII.—TAX ON ADMISSIONS AND DUES.

Section 800(a) omits or repeals paragraph 2 of subdivision (a) of section 800 of the revenue act of 1918. This paragraph provides that proprietors of theaters and similar places of amusement shall collect a tax from persons admitted free or at reduced rates upon the basis of the price charged to other persons for the same or similar accommodations furnished to other persons making full payment for admission. The effect of the repeal of this section will be to abolish the tax in the case of free admissions, and in the case of admissions at a reduced rate to impose the tax on the basis of the amount paid.

#### EXTENSION OF EXEMPTION FROM ADMISSION TAX.

Section 800 (b) amends subdivision (d) of section 800 of the revenue act of 1918 to extend the exemption from tax to amounts paid.

for admission, all the proceeds of which inure exclusively to organizations conducted for the purpose of improving any city, town, village, or other municipality, or exclusively to the benefit of persons who have served in the military or naval forces of the United States and are in need. This subdivision also extends the exemption, in the case of admissions to agricultural fairs, to exhibits, entertainments, or other pay features conducted by the fair association as part of such fairs, if the proceeds are used exclusively for the maintenance and operation of such agricultural fairs.

#### TITLE IX.—EXCISE TAXES.

Section 900 repeals section 900 of the revenue act of 1918 as of January 1, 1922. It retains all of the taxable items of section 900, but reduces the rates of certain of the items, and in one instance increases the rate. The important changes made in section 900 by the proposed bill are as follows:

The reduction of the tax imposed by subdivision 5 upon sporting goods from 10 to 5 per cent.

The reduction of the tax imposed by subdivision 6 upon chewing gum from 3 to 2 per cent.

The imposition of a 5 per cent tax upon photographic apparatus and accessories in subdivision 8.

The reduction of the tax on candy sold for not more than 40 cents per pound from 5 to 3 per cent. A tax of 10 per cent is imposed on candy selling for more than 40 cents per pound.

The imposition of a new tax of 5 per cent upon office furniture and fittings of mahogany, rosewood, or other imported cabinet woods (except oak).

The important changes proposed by the House bill to section 900 which are not included in the amendment recommended by your committee are as follows:

The exemption from the sporting-goods tax of 5 per cent of skates, snowshoes, skis, toboggans, baseball bats, gloves, masks, protectors, shoes and uniforms, football helmets, harness and goals, basket-ball goals and uniforms, baseballs, and footballs.

The repeal of the 5 per cent tax upon portable electric fans.

The reduction of the tax upon articles made of fur from 10 to 5 per cent.

The reduction of the tax imposed upon yachts and motor boats from 10 to 5 per cent.

The repeal of the 3 per cent tax upon toilet soaps and toilet-soap powders.

#### MANUFACTURERS DOING A WHOLESALE AND RETAIL BUSINESS.

Under existing law a manufacturer of any of the articles taxable under section 900 of the revenue act of 1918 doing a wholesale and retail business is permitted to compute the tax upon his retail sales upon the basis of his wholesale selling prices. The House bill eliminated this provision. The effect of the amendment proposed in the House bill would be to make each manufacturer compute the tax in the case of retail sales upon the amount received by the manufacturer from such sale, and would place manufacturers who have to engage

in the retail business in order to place their articles upon the market at a great disadvantage when competing with manufacturers who are able to sell entirely at wholesale. Your committee recommends the retention of the present method of computing the tax in the case of retail sales.

#### WORKS OF ART.

Section 902 of the revenue act of 1918 imposed a tax of 10 per cent upon the amount paid upon each sale of sculpture, painting, statuary, art porcelains, and bronzes. The provision exempted, however, sales by the artists and sales to educational institutions and public art museums. The House bill reduced the rate upon the sale of such articles to 5 per cent. Your committee recommends the retention of the 10 per cent imposed under existing law. But it recommends that this provision be modified so that the tax will not apply to sales between dealers.

#### LUXURY TAXES UPON ARTICLES SELLING ABOVE A FIXED PRICE.

Section 904 of the revenue act of 1918 imposed a tax of 10 per cent upon the selling price of specified articles selling above a fixed price. This section has been very difficult of administration, and has placed a burden upon retailers disproportionate to the revenue collected. The taxes imposed by this section are regarded as nuisance taxes, and your committee recommends their repeal as of January 1, 1922. It is recommended, however, that a tax be imposed upon the manufacturer equivalent to 5 per cent of so much of the amount paid for any of the following articles as is in excess of the price hereinafter specified as to each such article: Carpets in excess of \$4 per square yard; rugs in excess of \$6 per square yard; trunks in excess of \$35 each; valises, traveling bags, suit cases, hat boxes, and fitted cases in excess of \$20 each; purses, pocketbooks, shopping and hand bags in excess of \$5 each; portable lighting fixtures, including lamps of all kinds and lamp shades, in excess of \$10 each; fans in excess of \$1 each.

The taxes imposed by this section are proposed by your committee as a substitute for the manufacturers' taxes proposed by section 808 of the House bill on similar articles.

#### EYEGLASSES AND SPECTACLES.

Section 905 of the revenue act of 1918 imposed a tax of 5 per cent upon all articles made of or ornamented, mounted or fitted with precious metals or imitations thereof. The effect of this provision was to impose a tax upon spectacles and eyeglasses mounted or fitted with precious metals or imitations thereof. The House bill excepted eyeglasses and spectacles from this section, and your committee recommends that this exception be approved.

#### TAX UPON HOTEL CHARGES.

Section 907 of this bill introduces a new tax of 10 per cent of the amount paid to any hotel by a transient for the use of a room costing more than \$5 per day for one person or more than \$8 per day for

more than one person. Suitable provisions are made for suites of rooms and for accommodations furnished on the American plan.

#### PERFUMERY, COSMETICS, AND MEDICINES.

Section 907 of the revenue act of 1918 imposes a retail sales tax upon perfumery, cosmetics, and medicines held out or recommended to the public as remedies or specifics for any disease. The House bill repealed this section, the repeal to be effective upon the passage of the act. Your committee recommends that this section be repealed as of January 1, 1922, and that with respect to medicines no substitute tax be adopted. But it recommends that a manufacturer's sales tax of 4 per cent be imposed upon the articles taxable under paragraph (1) of subdivision (a) of section 907 of the revenue act of 1918. This paragraph includes perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes, dentifrices, tooth pastes, aromatic cachous, toilet powders (other than soap powders), or other similar substance, article, or preparation intended to be used for toilet purposes. In the Senate bill this tax is included as paragraph (22) of subdivision (a) of section 900.

#### TITLE X.—SPECIAL TAXES.

##### REPEAL OF CAPITAL-STOCK TAX.

Section 1000 provides for the repeal of the capital-stock tax imposed by section 1000 of the revenue act of 1918 after June 30, 1922.

##### COMPUTATION OF TOBACCO MANUFACTURERS' SPECIAL TAX.

Section 1001: Following the past policy of the United States in exempting from tax sales for export, your committee recommends an amendment, included as the last paragraph of section 1001, to provide that in computing the special tax upon manufacturers of tobacco products export sales of such products shall not be included.

##### TAX UPON THE USE OF YACHTS AND MOTOR BOATS.

Section 1002: The House bill excepted from special tax upon the use of yachts and motor boats on and after January 1, 1922, yachts and boats of not over 5 net tons and not over 32 feet in length. Your committee recommends that the exemption proposed be agreed to; that the amendment providing that the exemption shall become effective after June 30, 1922.

#### TITLE XI.—STAMP TAXES.

##### POLICIES OF GUARANTY AND FIDELITY INSURANCE.

Schedule A, in subdivision 2, contains a proviso imposing a tax of 1 per cent upon the premium charged for the issuance, execution, renewal, or continuance of indemnity and surety bonds, including policies of guaranty and fidelity insurance. The House bill struck

out this proviso, the effect being to impose a documentary tax of 50 cents upon each such policy, which would in many cases result in an increase over the tax measured by the premium. Your committee recommends that the House amendment be not agreed to.

#### STAMP TAX ON TRANSFER OF NO PAR VALUE STOCK.

Subdivision 4 of schedule A of Title XI of the revenue act of 1918 imposes a tax of 2 cents on the transfer or sale or agreement to sell each share of no par value stock, but provides that where the actual or market value of such no par value stock exceeds \$100 per share, the tax shall be 2 cents on each \$100 of actual value or fraction thereof. This provision of law is hard to administer owing to the difficulty of checking the valuation of such stock, which in many cases is not sold regularly on the market. In the interests of simplification your committee recommends that the tax shall in every such case be 2 cents per share irrespective of the actual value of the stock.

In order to avoid double or multiple taxation, it is also provided in paragraph 4 that the stamp tax on the transfer of certificates of stock shall not apply "upon mere loans of stock nor upon the return of stock so loaned."

### TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

#### METHOD OF COLLECTING TAX.

Section 1301 takes the place of section 1307 of the revenue act of 1918, and extends the authority of the commissioner in the case of all taxes other than income, excess profits, war profits, and estate, to collect the same by stamp, coupon, or serial-number ticket. The prior laws permitted the commissioner to prescribe the manner of collection only in the case where the manner was not provided by law.

#### UNNECESSARY EXAMINATIONS.

Section 1309 is designed to meet the complaint of taxpayers that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents. This section provides that no taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of the taxpayer's books of account shall be made for each taxable year, unless the taxpayer requests otherwise or unless the commissioner, after investigation, notifies the taxpayer, in writing, that an additional inspection is necessary.

#### FINAL DETERMINATION OF TAXES.

Section 1312 authorizes the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury and with the consent of the taxpayer, to reach a final settlement in tax cases which shall not be reopened or modified by any officer, employee, or agent of the United States, and which shall not be annulled or set aside by any court of the United States.

Under the present method of procedure a taxpayer never knows when he is through, as a tax case may be opened at any time because

of a change in ruling by the Treasury Department. It is believed that this provision will tend to promote expedition in the handling of tax cases and certainty in tax adjustment. Your committee, therefore, recommends its adoption.

INTERPRETATIVE REGULATIONS OR TREASURY DECISIONS NOT TO BE  
RETROACTIVE.

Section 1314 of the proposed bill authorizes the commissioner, with the approval of the Secretary, to provide in making a regulation or Treasury decision which reverses a prior regulation or Treasury decision (if it is not immediately occasioned by a decision of a court of competent jurisdiction) that the new regulation or Treasury decision may be applied without retroactive effect.

REFUNDS.

Section 1316 amends section 3228 of the Revised Statutes in order to provide that a taxpayer must present a claim for the refund of taxes within four years (instead of two years) after the payment of the tax. (See discussion under sec. 250, Title II.)

LIMITATIONS UPON SUITS AND PROSECUTIONS.

Section 1318 amends section 3226 of the Revised Statutes in order to provide, as set forth under section 250, Title II, that no suit for the recovery of any internal-revenue tax may be begun after the expiration of five years from the date of the payment of such tax. At present the provisions of section 3227, which state that suit must be brought within two years after the cause of action accrued, do not provide a definite time and make the limitations depend upon the filing of a claim for refund rather than on the payment of the tax.

Section 1319 repeals section 3227 of the Revised Statutes because of the reasoning above.

Section 1320 prevents the bringing of any suit or proceeding by the Government in any court for the collection of internal-revenue taxes after the expiration of five years from the time such tax was due, except in the case of fraud or a willful attempt to defeat or evade tax. (See sec. 250, Title II.)

Section 1321 amends the act which prescribes limitations upon prosecutions of misdemeanors in internal-revenue cases and extends the period from two to three years.

ASSESSMENTS.

Section 1322 extends the period in which internal taxes (other than income and profits taxes) may be assessed to four years. This corresponds to the extension of time given to the taxpayer in which to file claim for refund.

INTEREST ON REFUNDS.

Section 1324 makes an important change from existing law in providing that interest shall be paid on the overpayment of taxes at the rate of 6 per cent a year as follows:



(1) If such amount was paid under a specific protest, from the time when the tax was paid, or (2) if such amount was not paid under protest but pursuant to an additional assessment, from the time such additional assessment was paid, or (3) if no protest was made and the tax was not paid pursuant to an additional assessment, from six months after the date of filing of such claim. This provision is inserted for the purpose of expediting the refund of taxes and compelling the Government, in the event that such refund is unnecessarily delayed, to pay interest at the ordinary rate.

#### TAX SIMPLIFICATION BOARD.

Section 1327 provides for the establishment of a tax simplification board to investigate the procedure of and the forms used by the Internal Revenue Bureau and to make recommendations in respect to the simplification thereof. The members of the board are to serve without compensation and the board will cease to exist on December 31, 1924.

#### LIBERTY BOND TAX EXEMPTIONS.

Section 1328 provides for the simplification of the Liberty bond tax exemptions. The exemptions from income surtaxes authorized by the several Liberty bond acts are highly complex and responsible for perhaps the most intricate schedule of the income-tax return which the individual taxpayer is required to fill out. This section proposes to grant taxpayers an exemption for graduated additional income taxes and excess profits and war-profits taxes until the expiration of two years after the date of the termination of the war between the United States and the German Government, as fixed by proclamation by the President, on \$125,000 aggregate principal amount and for three years more on \$50,000 aggregate principal amount of the 4 per cent and 4½ per cent Liberty bonds.

The Secretary of the Treasury, at page 99 of his annual report for the fiscal year ending June 30, 1919, made the following statement relative to the provision included in this section:

The only objection to these simplified arrangements which occurs to the Treasury is that they may confer upon holders of bonds who did not subscribe or hold bonds or notes as required by the acts of Congress, certain exemptions from taxation which were conferred upon original subscribers. On the other hand, they take away no right which any holder has, and in so far as they confer rights upon those not now holders they will in the end benefit original subscribers who are still holders by improving the market value of their bonds or notes. It is impossible to present any accurate calculation of the consequences to the Treasury of the amendments of the law proposed. I do not hesitate, however, to express my confident judgment that the loss in revenue will be relatively slight and that the gain to the Treasury which will result from the increased attractiveness of the taxable issues of the Liberty loans and the consequent benefit to the Government's credit, as well as the simplicity of administration, will amply compensate the Treasury for that slight loss.

#### REPORT OF ENTRY OF PETITION IN BANKRUPTCY.

Section 1016 of the House bill amended section 3466 of the Revised Statutes to require the clerk of the district court to give the Commissioner of Internal Revenue notice of entry of all petitions in bank-

ruptey. The Attorney General is of the opinion that this provision places an undue amount of work upon the clerks of the district courts, who are already overburdened with work, and therefore your committee recommends that this provision be not agreed to.

#### CONSOLIDATED RETURNS FOR YEAR 1917.

Section 1331 provides for the validation of the consolidated return regulations under the revenue act of 1917. For the year 1917 affiliated corporations were permitted or required to make consolidated returns for the purposes of the excess-profits tax. Owing to the equivocal language in the revenue act of 1917 some doubt exists concerning the legality of this procedure. In order to set all doubts at rest, it is deemed advisable to validate the practice of the Treasury Department under the revenue act of 1917. Such validation is particularly necessary, as the taxation of the largest corporations is determined upon the basis of the consolidated return.

#### ALTERNATIVE TAX ON PERSONAL-SERVICE CORPORATIONS.

Section 1332 provides that in case the present method of taxing personal-service corporations (i. e., on the same basis as partnerships) is declared unconstitutional such corporations shall be taxed for the years 1918 to 1921, inclusive, upon the same basis as other corporations. The shareholders who during such years have paid taxes upon their distributive shares would be entitled to refunds for the taxes so paid. Provision is made that such taxes paid by the shareholders may, under a written agreement, be credited against the taxes due from the corporation; that if no stockholder files a claim for refund within a period of six months the taxes paid in the past by the shareholders shall be deemed to be in lieu of the tax imposed by this section; and that if claims for refund are filed within six months representing less than 30 per cent of the outstanding stock or shares in the corporation the tax imposed by this section shall be reduced to that proportion thereof which the number of shares owned by the shareholders making such claims bears to the total number of shares outstanding.

This section is deemed advisable because the stock-dividend decision has cast doubt upon the constitutionality of the provisions of the revenue act which treat personal-service corporations substantially as partnerships.

#### TITLE XIV.—GENERAL PROVISIONS.

##### INCREASE IN NOTE AUTHORIZATION.

Section 1401 authorizes the Treasury Department to have outstanding at any one time \$7,500,000,000 of notes (as distinguished from certificates or long-time bonds) in place of \$7,000,000,000 of such notes in the aggregate authorized by existing law. The authorized amount is thus increased from \$7,000,000,000 to \$7,500,000,000 and the Treasury would, under the suggested provision, be permitted to have the larger amount outstanding at any one time. This change in the law is not for the purpose of covering by borrow-

ing any deficiency in the total tax revenue raised by this bill. The amount authorized, \$7,500,000,000, is approximately the amount of short-time debt now outstanding which, according to the plans already announced by the Treasury, is to be distributed into more convenient maturities.

The authority conferred by the bill is similar to that already committed to the Secretary of the Treasury as to certificates of indebtedness maturing in one year or less. The Secretary is, under existing law, authorized to issue and have outstanding at any one time an aggregate of \$10,000,000,000 in short-time certificates of indebtedness, of which at the present time about \$2,750,000,000 are outstanding. This increase in authorization as to notes maturing in from one to five years is necessary to enable it to transfer, before May 20, 1923, as much of its short-time debt now outstanding as possible into notes of maturity of not more than five years.





# Calendar No. 289.

67TH CONGRESS, }  
1st Session. }

SENATE.

{REPORT 275,  
{ Part 2.

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## INTERNAL REVENUE BILL OF 1921.

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OCTOBER 4 (calendar day, OCTOBER 5), 1921.—Ordered to be printed.

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

### MINORITY VIEWS.

[To accompany H. R. 8245.]

The platform of the Republican Party, adopted by the convention of 1920, upon which the present administration and Congress were elected, promised the revision and simplification of the Federal tax laws. This promise has not been fulfilled in H. R. 8245, either as the bill passed the House of Representatives or as the bill was reported to the Senate with amendments by the Republican majority of the Senate Committee on Finance. The character of the taxes has not been changed except in one or two instances. Simple tax laws have not been substituted for complex tax laws, and no provision has been made or proposed for the simplification of the law. The reductions that have been made are of a character and were apparently intended to be such that would relieve certain favored classes of taxpayers at the expense of the great body of the taxpayers.

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### WAR REVENUE LEGISLATION.

The revenue acts of 1917 and 1918 were improvised to meet the conditions created by the World War. Tens of billions of dollars were required by the Government to meet the heavy responsibilities which it was compelled to assume. It was understood that large profits had been and would be made by corporations, and that personal incomes would be greatly increased by reason of the war, and the people of the country generally approved of revenue legislation which imposed heavy taxes upon corporations and individuals enjoying large incomes. The war revenue legislation was largely experimental and found no precedent in former enactments of Congress devised either in war or in peace times. To reach the objects and sources of taxation desired was a most difficult task, but both political parties adopted with unanimity the war revenue legislation referred to, believing that it was

justified in war times and under the then existing conditions. Its repeal was promised by all as soon as war was over. It was understood by the responsible leaders of both political parties and by the country generally that upon the termination of the war a fair, just, and, so far as possible, a scientific system of taxation should be adopted suited to peace times. As hereinafter stated, President Wilson immediately after the termination of the war urged relief from the burdens of taxation which the war imposed and a system of taxation suitable for peace conditions.

The Republican Party in the elections of 1918 promised fiscal reforms and relief from the burdens of war revenue legislation, and these promises were repeated and emphasized in the recent presidential election. Promises of economy and retrenchment were the basis of frenzied appeals to the country for the return to power of the Republican Party. President Harding in his very first message to the Congress appealed for a simplified tax system. But these promises the Congress has not fulfilled. A rational revenue measure has not been proposed, and the manifest lack of economy on the part of the administration has made it impossible to effectuate promised reforms or to bring relief from oppressing taxation to the great mass of the American people.

#### THE PRESENT FISCAL PROBLEM.

Honesty and statesmanship alike demanded that the party in power state to the country its inability to redeem the promises made that retrenchment and tax reduction would immediately follow Republican success, and likewise demanded the enactment of laws which would yield sufficient revenue to meet the expenditures of the Government, but instead there has been an inexcusable juggling of figures and efforts to perform feats of legerdemain, apparently for the purpose of concealing from the country the actual condition of the finances and disguise the incompetency of the party in power to formulate a system of taxation just and equitable and adequate for the fiscal requirements of the Government. The following statements will show the justice of this criticism with reference to estimates and appropriations.

The Secretary of the Treasury on the 4th of August last appeared before the Ways and Means Committee of the House and submitted estimates of expenditures for the fiscal year 1922. These estimates are as follows:

Legislative .....	\$17, 213, 813	
Executive .....	1, 897, 751	
State Department.....	10, 844, 000	
Department of Justice.....	17, 000, 000	
Post Office Department .....	2, 200, 000	
Interior Department (including pensions and Indians).....	322, 000, 000	
Department of Agriculture.....	123, 000, 000	
Department of Commerce.....	19, 923, 000	
Department of labor.....	5, 252, 887	
Independent offices.....	13, 484, 516	
District of Columbia.....	22, 177, 663	
Miscellaneous.....	62, 500, 000	
		\$617, 003, 630
Postal deficiency .....	70, 000, 000	

## Treasury Department:

Bureau of War Risk Insurance	\$286,000,000	
Public Health Service	47,000,000	
Collecting revenue	53,110,139	
All other	99,457,795	
		\$485,567,934
Federal Board for Vocational Education		162,555,184
War Department		450,000,000
Navy Department		487,225,000
Shipping Board		200,000,000
Railroads (transportation act and Federal control)		545,208,204
Interest on public debt		975,000,000
Panama Canal		10,000,000
		<u>\$3,385,654,322</u>

Total ordinary		4,002,657,952
Public debt expenditures required by law:		
Sinking fund	265,754,865	
War-savings securities (net)	100,000,000	
Miscellaneous debt redemptions	100,000	
Purchases of Liberty bonds from foreign repayments	30,500,000	
Redemptions of bonds and notes from estate taxes	25,000,000	
Retirement of Pittman Act certificates	70,000,000	
Retirement from Federal Reserve Board franchise tax receipts	60,000,000	
Total retirements		<u>551,854,865</u>

Grand total ordinary expenditures (including sinking fund and miscellaneous debt retirements) 4,554,012,817

It is well understood that these estimates submitted by Secretary Mellon were regarded by the administration as the irreducible minimum. The policies and program of the party in power will imperatively demand appropriations greatly in excess of those contained in the estimates submitted by Secretary Mellon. It is therefore within the domain of certainty that large deficits will exist even though funds to the extent of \$4,554,012,817, as requested in Secretary Mellon's statement, are obtained.

Apparently, it was the purpose of the administration to meet the expenditures of the Government, not by adequate taxation but, in part, by creating further debts through the issuance of certificates of indebtedness or other forms of Federal obligations. A fiscal policy of this character in the present circumstances can not be defended. However, it must be conceded that Secretary Mellon in the first instance acted with greater frankness than did the committee reporting the pending bill in the House, and the Finance Committee of the Senate, which presents the House bill with numerous and rather immaterial modifications in this respect.

The Secretary appreciated that with the large appropriations made by Congress additional revenues would be required, and he made certain recommendations, which, however unwise, as a source of additional taxation to offset taxes to be remitted to corporations and the superrich, would have materially increased the revenues of the Government, and was an honest and frank plan, though it seems the impolitic recognition and acknowledgment of the fact that if sufficient revenues were to be realized to meet the estimated requirements no reductions in existing taxes could be made by way of re-

ductions in rates of repeals of existing levies unless new taxes were imposed, and the party in power had promised there should be no new taxes in the bill. He suggested an increase in the documentary stamp taxes by doubling the present rates, thereby increasing the revenue from this source to the extent of \$30,000,000 for the fiscal year 1922, and \$70,000,000 for the fiscal year 1923. A stamp tax of 2 cents on each bank check was recommended, from which forty-five millions per year would be added to the Treasury.

An increase of 1 cent in the rate of postage on first-class mail matter was suggested, from which the Secretary estimated seventy-two millions per year in revenue would be obtained. An annual Federal license tax upon motor vehicles was recommended, from which one hundred millions per year would be obtained. A further increase in the tax on cigarettes and a slight increase in other taxes on tobacco products were recommended, from which the Secretary estimated additional revenue of twenty-five millions in the fiscal year 1922 would be obtained and approximately fifty-seven millions in the fiscal year 1923. These new taxes in the scheme of the Secretary were to take the place of the taxes on corporations (excess profits, capital stock, and surtaxes on dividends) and the taxpayers with large incomes, which taxes he recommended should be repealed, as to excess profits and capital-stock taxes, and reduced one-half as to surtaxes on dividends.

When it became apparent that the recommendations of the Secretary with reference to the imposition of new taxes (though it was willing to make the repeal of taxes so recommended by him), would not be followed by the House, a conference was held by the President, the Secretary of the Treasury, and other officials of the administration and it is understood that at such conference it was urged that savings must be made in the appropriations carried in the general appropriation bills for the current fiscal year. It was announced that by reducing expenditures below estimates of appropriations in the War Department, Navy Department, Agricultural Department, and Shipping Board a saving of \$350,000,000 would result.

Following this conference Secretary Mellon, on the 10th day of August, submitted a letter addressed to the chairman of the Ways and Means Committee enumerating the reductions in departmental expenditures and the savings which it was thought might be made—also his purpose to eliminate from his estimates of August 4 of expenditures for the current fiscal year \$100,000,000, which had been authorized for the payment of maturing war savings securities, and \$70,000,000 which had been authorized for the retirement of certificates issued under what is known as the silver coinage act. In the statement issued by the Secretary on the 10th of August suggestions were made to the effect that instead of paying this \$170,000,000 from current revenues the Government should borrow an equivalent amount by the issuance of Treasury certificates. In this disingenuous manner the Treasury was to be relieved from the payment of these large maturing obligations aggregating \$520,000,000 for which appropriations had been made. It will be remembered that the execution of this policy would involve the issuance of short-time evidences of indebtedness by the Government bearing high rates of interest, but that it will make possible a reduction in taxes to this extent and give opportunity to make the repeals he recommended.



This plan is not only a subterfuge as it relates to the present relief to be obtained by the Treasury thereby, but is also essentially a reprehensible method of meeting the financial obligations of the Government.

Referring to the reported action of the conference and the suggestion that three hundred and fifty millions would be saved from the appropriations for the current fiscal year, it is pertinent to remark that the appropriations authorized still stand, and no bill has been introduced to return to the Treasury any portion of said alleged savings. No revocation of the authorization for the payment of these amounts has been proposed. It is safe to assume that the appropriations made will be expended, and it is certain that if any technical savings are realized they will merely be absorbed in the inevitable deficit, and will not be available for any other purpose. Not only is it believed that there will be large deficits, but the commitments of the administration, for extraordinary appropriations, are such that unprecedented sums of money must be raised to satisfy the same. Of course, however, if the \$350,000,000 agreed to cut out of the expenditures authorized by the appropriation for the departments is not saved and the full amount is spent, the Secretary is authorized under law (Liberty bond act) to borrow the money on certificates of indebtedness. While borrowing money on the faith of the Government to defray current expenses is, of course, bad policy, unbusinesslike, and unstatesmanlike, it is a smart expediency to relieve against a dilemma such as confronted the Secretary and the administration.

#### THE BILL AFFORDS NO PRESENT RELIEF.

There is nothing to be gained by the forced and inconsiderate enactment of the present bill. The bill affords no relief to the country. There will be no reductions effective during this calendar year—nine months after the advent to full power of the party which promised immediate relief from oppressive taxes. Practically every change in the rates or repeal of present taxes is postponed until January 1, 1922, and the reductions made after January 1, 1922, are to be accomplished through promised cuts in expenditures that may not materialize, with contingent borrowings in that event as well as certain borrowings to pay the \$170,000,000 estimated to meet savings stamps and Pittman Act redemptions and expenditures.

#### NEED FOR NEW LEGISLATION.

Now that the committee and its advisers have exhausted themselves in an endeavor to elaborate an improved revenue system on the basis of the present law, which effort it appears is utterly nugatory and abortive, it is plainly in order that there be a new and original examination of the whole field of Federal fiscal policy and of Federal revenue resources and that a rational measure be formulated which shall raise the required revenues in the most equitable and effective manner and with the utmost facility of collection and equity of incidence which is possible under the facts, information, and experience available. The mere mulling over, ruminating, diges-

tion, and amendment of the present revenue law will avail comparatively little for this purpose, and this is all which the committee have undertaken to do. The result is wholly unsatisfactory from any standpoint. The country is bound to be dissatisfied, and those who are charged with the administration of the fiscal affairs of the Government are bound to be disappointed if the bill which is pending is enacted into law.

There is nothing sacred about the present revenue law. It was improvised to meet the emergency of war, and, although it was passed by a Congress having Democratic majorities in both Houses and signed by a Democratic President, it was the work of Congress as such, and can not fairly be said to have embodied any deliberate or settled policy or principle professed by either the Republican or Democratic Party. The question of Federal revenue revision is too broad, too vital to the country, and too important to the Government to be approached in any partisan attitude or from any partisan standpoint. This fact has been recognized both by the present Chief Executive and by his predecessor.

In his message at the opening of the special session of the present Congress, President Warren G. Harding said:

The most substantial relief from the tax burden must come for the present from the readjustment of internal taxes and the revision or repeal of those taxes which have become unproductive and are so artificial and burdensome as to defeat their own purpose. A prompt and thorough revision of the internal tax laws, made with due regard to the protection of the revenues, is, in my judgment, a requisite of the revival of business activity in the country. \* \* \* We are committed to the repeal of the excess-profits tax and the abolition of inequities and unjustifiable exasperations in the present system. The country does not expect and will not approve a shifting of burdens. It is more interested in wiping out the necessity for imposing them and eliminating confusion and cost in the collection.

It is apparent that the country is not to be served at the present time by an inconsiderate amendment or replacement of the existing tariff law; and, in view of the unsatisfactory character of the pending revenue bill, it ought to be equally apparent that the country is not to be served by the present enactment of this measure. There is from any standpoint quite as much reason, indeed more, for well elaborated and deliberate action upon the subject of revenue revision as there is upon the subject of tariff revision. These subjects of legislation are but divisions of the same great field of Federal fiscal policy and administration. No mere amendments or additional improvised legislation will fully satisfy the requirements of the case.

President Woodrow Wilson, in his address to Congress on the 20th day of May, 1919, only three months after he had approved the revenue act of 1918, which is the present law, not only clearly recognized the necessity of a fundamental rectification and adjustment of the whole system of internal taxation, but also outlined in trenchant and certain recommendations the general principles and course which should be followed in accomplishing this purpose. The President said:

Credit and enterprise alike will be quickened by timely and helpful legislation with regard to taxation. I hope that the Congress will find it possible to undertake an early reconsideration of Federal taxes, in order to make our system of taxation more simple and easy of administration and the taxes themselves as little burdensome as they can be made and yet suffice to support the Government and meet all its obligations. \* \* \*

The main thing we shall have to care for is that our taxation shall rest as lightly as possible on the productive resources of the country, that its rates shall be stable, and that it shall be constant in its revenue-yielding power. We have found the main sources from which it must be drawn. I take it for granted that its mainstays will henceforth be the income tax, the excess-profits tax, and the estate tax. All these can so be adjusted, to yield constant and adequate returns and yet not constitute a too grievous burden on the taxpayer. A revision of the income tax has already been provided for by the act of 1918, but I think you can find that further changes can be made to advantage both in the rate of the tax and in the method of its collection. The excess-profits tax need not long be maintained at the rates which were necessary while the enormous expenses of the war had to be borne, but it should be made the basis of a permanent system which will reach undue profits without discouraging the enterprise and activity of our business men. The tax on inheritances ought, no doubt, to be reconsidered in its relation to the fiscal systems of the several States, but it certainly ought to remain a permanent part of the fiscal system of the Federal Government also.

Many of the minor taxes provided for in the revenue legislation of 1917 and 1918, though no doubt made necessary by the pressing necessities of the war time, can hardly find sufficient justification under the easier circumstances of peace and can now happily be got rid of. Among these, I hope you will agree, are the excises upon the various manufactures and the taxes upon retail sales. They are unequal in the incidence on different industries and on different individuals. Their collection is difficult and expensive. \* \* \* I can only suggest the lines of a permanent and workable system, and the placing of the taxes where they will least hamper the life of the people.

Supplementing these recommendations, President Woodrow Wilson in his annual message to Congress on December 7, 1920, said:

The fundamental fact which at present dominates the Government's financial situation is that seven and one-half billions of its war indebtedness mature within the next two and one-half years. Of this amount, two and one-half billions are floating debts and five billions victory and war savings certificates. The fiscal program of the Government must be determined with reference to these maturities. Sound policy demands that Government expenditures should be reduced to the lowest amount which will permit the various services to operate efficiently, and that Government receipts from taxes and salvage be maintained sufficiently high to provide for current requirements, including interest and sinking fund charges on the public debt, and at the same time retire the floating debt and part of the victory loan before maturity.

\* \* \* Closely connected with this, it seems to me, is the necessity for an immediate consideration of the revision of our tax laws. Simplification of the income and profits taxes has become an immediate necessity. These taxes performed an indispensable service during the war. The need for their simplification, however, is very great, in order to save the taxpayer inconvenience and expense and in order to make his liability more certain and definite. Other and more detailed recommendations with regard to taxes will no doubt be made before you by the Secretary of the Treasury and the Commissioner of Internal Revenue.

It is apparent from these earnest recommendations of President Harding to the present Congress, and of President Wilson to the last Congress, for a thoroughgoing rectification of the inequalities, ineffectualities, and complexities of the Federal revenue system, that the problem of Federal revenue revision is in no sense a partisan project. The recommendation of President Wilson, who was intimately in contact with the problem and with the times and occasions which wrought such great changes in the fiscal affairs of the country, are entitled to frank and impartial consideration by the present Congress. If these recommendations had been heeded the revenue bill reported by the majority of the committee would have been more acceptable to the country and advantageous to the Government than it is in its present form.

## FUTILITY OF THE PENDING BILL.

The plain fact is that the pending bill neither fulfills the promises of the Republican Party for a simplification of tax law and procedure nor satisfies the demand of the Democratic Party for a complete survey of existing taxes and their modification and simplification, with a view to greater equity and justice in the tax burden and improvement in the administration of the tax laws. The bill is not a justification—it is, indeed, not even a poor excuse—for the time which has been expended upon it. The country has not been given the relief which was confidently expected. The committee has failed to provide for the simplification and equalization of the income and corporation taxes and the repeal of the multitude of excises which are a constant annoyance to the public, but instead has proceeded to reduce rates and repeal taxes in a way that unbalances the whole system and relieves the corporations and ultrarich of hundreds of millions of taxes, most of which is shifted to the shoulders of the masses.

## SURTAXES.

Under existing law the surtaxes are imposed in brackets ranging from 1 to 65 per cent. Under the pending bill it is proposed to reduce these rates from 65 to 32 per cent upon incomes exceeding \$66,000, but the bill proposes only a slight reduction of 1 per cent on incomes between \$5,000 and \$20,000. It also increases the rate 1 per cent on incomes between \$20,000 and \$32,000.

The purpose of the Republican majority seems to have been centered upon the exemption of millionaires from the higher surtaxes and the exemption of corporate interests and monopolies from the payment of proper taxes upon inordinate profits. In pursuit of this purpose the committee has divided the income taxpayers of the country into two classes. The first class consists of those persons who have incomes greater than \$66,000 a year; the second class consists of those persons who have incomes of less than \$66,000 a year. The average income of persons in the first class is more than \$150,000 a year. The average income of persons in the second class is but \$3,400 per year, which must sustain the cost of living of themselves and millions of their dependents.

There are 11,077 millionaires in the first class and 5,321,683 people in the second class; \$66,000 is 6.6 per cent interest on \$1,000,000 for one year. A person having such an income is, by the capitalization of his income and without regard to his holdings of nonproductive property and estates, a real millionaire. The committee in its solicitude for wealth has accorded these 11,077 millionaires very substantial relief by the repeal of the higher brackets of the surtaxes, which range from 32 to 65 per cent, a reduction of more than 50 per cent in the rates, while the 5,321,683 ordinary taxpayers have been given no substantial relief. All that has been accorded them is a shifting of the initial incomes for surtaxes from five to six thousand dollars and a slight increase in the exemption for heads of families.

As illustrating the effect of these reductions upon surtaxes above \$66,000 and below \$66,000, we here submit a comparative table showing the difference in surtaxes between existing law and the proposed bill as amended by the Senate Finance Committee upon all surtax brackets.

Comparative table showing difference in surtaxes between present bill and Senate Finance Committee bill upon all income-class brackets.

[Tax computed on the basis of net income of a married man without dependents.]

SURTAXES.

Brackets.	Individual tax, present law.	Individual tax, Senate bill.	Difference.	Brackets.	Individual tax, present law.	Individual tax, Senate bill.	Difference.
THOUSANDS.			Plus.	THOUSANDS.			Minus.
5-6.....	\$10		\$10	58-60.....	\$8,110	\$8,100	\$10
6-8.....	50	\$20	30	60-62.....	8,690	8,680	10
8-10.....	110	60	50	62-64.....	9,290	9,280	10
10-12.....	190	120	70	64-66.....	9,910	9,900	10
12-14.....	290	200	90	66-68.....	10,550	10,540	10
14-16.....	410	300	110	68-70.....	11,210	11,190	20
16-18.....	550	420	130	70-72.....	11,890	11,820	70
18-20.....	710	560	150	72-74.....	12,590	12,460	130
20-22.....	890	760	130	74-76.....	13,310	13,100	210
22-24.....	1,090	960	110	76-78.....	14,060	13,740	310
24-26.....	1,310	1,220	90	78-80.....	14,840	14,390	450
26-28.....	1,550	1,460	70	80-82.....	15,650	15,020	570
28-30.....	1,810	1,760	50	82-84.....	16,500	16,060	430
30-32.....	2,090	2,040	30	84-86.....	17,210	16,300	910
32-34.....	2,390	2,330	10	86-88.....	18,060	16,940	1,110
34-36.....	2,710	2,700	10	88-90.....	18,910	17,590	1,320
36-38.....	3,060	3,040	10	90-92.....	19,780	18,860	1,530
38-40.....	3,440	3,400	10	92-94.....	20,690	18,960	1,830
40-42.....	3,790	3,780	10	94-96.....	21,610	19,500	2,110
42-44.....	4,190	4,180	10	96-98.....	22,550	20,140	2,410
44-46.....	4,610	4,600	10	98-100.....	23,510	20,790	2,720
46-48.....	5,050	5,040	10	100-150.....	49,510	36,780	12,730
48-50.....	5,510	5,500	10	150-200.....	77,510	52,790	14,730
50-52.....	5,990	5,980	10	200-300.....	137,510	84,790	52,730
52-54.....	6,490	6,480	10	300-500.....	263,510	148,790	114,730
54-56.....	7,010	7,000	10	500-1000.....	583,510	308,790	274,730
56-58.....	7,550	7,540	10				

We also insert the following table, which somewhat simplifies the above statement:

Income.	Present law.	Proposed law.	Income.	Present law.	Proposed law.
\$10,000.....	\$110	\$60	\$30,000.....	\$15,590	\$15,020
\$20,000.....	710	560	\$90,000.....	18,910	17,590
\$30,000.....	1,810	1,760	\$100,000.....	23,510	20,790
\$40,000.....	3,410	3,400	\$200,000.....	77,510	52,790
\$50,000.....	5,510	5,500	\$300,000.....	137,510	84,790
\$60,000.....	8,690	8,680	\$500,000.....	263,510	148,790
\$70,000.....	11,890	11,820	\$1,000,000.....	583,510	308,790

There has, moreover, been no simplification, equalization, or overhauling of the rates for the great mass of income-tax payers. The few involved amendments to the law will further complicate the work of making their income-tax returns, and make it practically necessary that they employ the aid of a lawyer or accountant for this purpose.

TAXATION OF EXCESS PROFITS, CORPORATION EXEMPTIONS, AND THE CAPITAL-STOCK TAX.

We have been told that the Republican Party is committed to the exemption of the great and concentrated corporate wealth of the country from the taxes presently laid upon excess profits. In the pending bill there has been a consistent pursuit of this policy. The

war rates on war profits and excess profits imposed by the revenue law of 1917, which was approved October 3, 1917, ranged up to 60 per cent for the war excess-profits tax, and the tax was made to apply to every business making profits, whether conducted by corporations, partnerships, or personal proprietors.

Why should an exemption of \$2,000 be allowed domestic corporations as proposed in the bill with respect to the corporate income tax? This exemption applies to all corporations, small and great. It is apparently considered that a corporation which is allowed to deduct its expenses of every kind and nature from its gross income before any taxes are laid on its net income is entitled to the same consideration and solicitude as the head of a family who is now allowed an income-tax exemption of \$2,000, and who is not permitted to deduct any of his living expenses or the living expenses of his family, before the imposition of the tax upon his income. There is no sound reason why a corporation engaged in the employment of capital for profit and which is permitted to deduct all expenses, including the salaries of the officers, before its income or profits are taxed, should be allowed any exemption of its profits from the application of the corporate income tax. Not only is the excess-profits tax against corporations to be entirely repealed, but the \$2,000 exemption for all corporations, including the trusts and corporate monopolies, is to be continued out of an undue solicitude for the profits of corporations.

Apparently for the same reason, for there seems to be no other logical reason for such action, the Senate bill provides that the present capital-stock tax which raises seventy-five millions of revenue annually shall be repealed as of June 30, 1922. By the simple retention of the capital-stock tax and the repeal, as was recommended by Secretary Mellon on August 4, 1921, of the \$2,000 corporate exemption, revenues in excess of one hundred and thirty millions annually would be available for the Treasury. Certainly the policy of favoring corporations so extensively ought not to be pursued under the present conditions of the Treasury.

#### DISPARITY BETWEEN CORPORATION AND INDIVIDUAL AND PARTNERSHIP INCOME TAXES.

In the revision of 1918 it was found after investigation and calculation that with the excess-profits taxes, applicable alike to corporations, partnerships, and individual taxpayers, an indefensible discrimination existed in favor of the corporations as against individuals and partnerships. After earnest effort to find some method of equalizing this disparity it was finally determined that while the discrimination would not be totally removed, the disparity would be approximately removed by relieving the individuals and partnerships from excess-profits tax. At that time there was a tax on the capital stock of corporations. The pending bill would not only relieve corporations of excess-profits taxes but of the capital-stock tax. It is obvious that the effect of the repeal of these taxes will restore the disparity in this respect in taxes paid by corporations and those paid by individuals and partnerships. A table is hereto attached showing the extent of this disparity.

*Comparison of taxes on certain forms of business.*

[Percentage of total net income payable in tax. Surtax rates computed upon basis of House Bill.]

Class of business.	Net income.			
	\$1,000,000	\$500,000	\$100,000	\$50,000
Individual.....	<i>Per cent.</i> 38.85	<i>Per cent.</i> 37.69	<i>Per cent.</i> 31.19	<i>Per cent.</i> 18.38
Partnership:				
2 parties.....	37.69	35.39	18.38	11.52
4 parties.....	35.39	30.77	11.52	7.16
5 parties.....	34.23	28.47	7.96	5.90
8 parties.....	30.78	21.63	7.16	.....
Corporation, no dividends.....	15.00	14.94	14.70	14.20
50 per cent dividends:				
4 stockholders.....	26.49	22.01	15.56	15.26
5 stockholders.....	25.36	20.46	15.25	14.52
8 stockholders.....	22.04	18.12	14.78	14.20
10 stockholders.....	20.48	17.34	14.70	14.20
75 per cent dividends:				
4 stockholders.....	34.49	29.97	17.14	16.84
5 stockholders.....	33.36	27.73	16.45	15.12
8 stockholders.....	30.00	22.62	15.43	14.80
10 stockholders.....	27.76	20.87	15.10	14.40
20 stockholders.....	20.39	17.38	.....	.....
100 per cent dividends:				
4 stockholders.....	42.48	37.97	19.50	16.12
5 stockholders.....	41.36	35.73	18.25	15.50
8 stockholders.....	38.00	29.08	16.42	14.64
10 stockholders.....	26.84	25.96	15.80	14.40
20 stockholders.....	25.99	19.74	14.70	.....

Estimated upon the basis of the present bill, an individual with an income of \$1,000,000 will pay at the rate of 38.85. A partnership composed of 4 partners would pay 35.39 and of 10 partners 30.78. A corporation distributing no dividends would pay only 15 per cent. A corporation distributing 50 per cent of its net income in dividends with 10 stockholders would pay 20.48. A corporation distributing 75 per cent of its dividends—and that is about the estimated average of distribution—with 20 stockholders, would pay 25.39.

Of course this per cent would decrease as the number of stockholders increased. Upon the basis of a \$500,000 income an individual would pay 37.69. A partnership with four persons would pay 30.77. A corporation distributing 50 per cent of its earnings in dividends with 10 stockholders would pay 17.34. A corporation distributing 75 per cent of its earnings in dividends with 20 stockholders would pay 17.38.

It is not believed that this discrimination can be justified, and yet it is inevitable if excess-profits taxes on corporations and the capital-stock tax on corporations is repealed without some additional legislation, which is not proposed in this bill, is adopted to relieve that situation.

It is perfectly apparent that the 5 per cent increase on corporation incomes will not bring about this disturbed parity. The amendment offered by Senator Walsh, of Massachusetts, increasing by a graduated scale the income tax on corporations will to a considerable extent tend to the restoration of this parity.

## TRANSPORTATION TAX.

When we consider the high rates of transportation allowed and approved by the Interstate Commerce Commission, and the effect of

those high rates upon the business of the country and upon the profits of all the people there would seem to be no reason why this tax should not be immediately repealed. The present high freight and passenger rates of transportation while not the result of any tax, in a technical sense are the immediate result of the war and of the guaranties made by the Government allowing rates sufficient to afford a definite and certain income in the operation of railroads. The present tax upon transportation, estimated to yield for the fiscal year 1922 two hundred and sixty-odd millions of dollars, adds materially to the burden of high rates. It is asked that the excess-profits tax be repealed upon the ground that it is an impediment and clog to business. These high freight rates and the tax upon transportation is a burden not only to the business of corporations, but to the business of all the people of the country. As much as anything else, this transportation situation is impeding the business of the country and delaying a return to normal business conditions, and the same arguments that are advanced in behalf of the repeal of the excess-profits tax obtains with equal if not more force with reference to this tax. Notwithstanding this, the bill proposes to retain one-half of this tax, at least for another calendar year. In the opinion of the minority this tax ought to be repealed immediately. It is difficult to see how anyone can justify the repeal of the capital-stock tax on corporations while refusing to repeal in toto an even heavier tax upon transportation.

#### MISCELLANEOUS TAXES.

In the reductions of 1918 the war miscellaneous taxes were practically all retained without change. The only reduction in these taxes was the repeal of the 1-cent tax on postage at that time. The pending bill makes some changes in these taxes, repealing some, reducing some, and changing the base of taxation as to some; but the Actuary of the Treasury estimates that the total reductions as a result of these proposed amendments will not much exceed \$70,000,000, leaving out the reductions made on account of changes in the transportation and capital stock taxes, both of which are technically catalogued under the head of miscellaneous taxes, so that practically under this bill, while surtax and profits taxes are greatly reduced—practically cut in half for a second time—the miscellaneous taxpayers are to-day paying peak war-time taxes. At the time of the reductions of 1918 it was understood that when another reduction was made miscellaneous taxes would be given special consideration as to reductions. In these conditions it is to be hoped that the Senate may find some way to further reduce these taxes or substitute for them taxes of a less irritating, nagging, and vexing character.

#### CONCLUSION.

As has been said before, if the excess-profits tax, which is exclusively a corporation tax under existing law, is repealed, and the capital stock tax is repealed and the surtaxes upon corporate dividends in excess of \$66,000 is reduced as provided in the bill from 65 per cent to 32 per cent a fearful disparity will be produced in favor of corporations.



In the first place, even if the rate of corporate income tax is increased 5 per cent as proposed in the bill the net taxes remitted to the corporations would probably exceed \$400,000,000. This would cover the bulk of the net reductions proposed in the bill.

The repeal of the excess-profits tax would also result in a gross disparity between the amount of taxes hereafter to be paid by corporations, individuals, and partnerships. If the total repeals of corporate taxes provided in the bill are adopted the amount corporations would pay on the net income plus the amount of surtax which the stockholders would pay on dividends would be but little more than one-half of that paid on individual incomes and hardly two-thirds as much as that paid on partnership incomes.

It is suggested, if the Senate should adopt the amendments proposed in the bill as to profit tax, capital-stock tax, and dividend surtaxes, thus creating this discrimination and disparity, that every consideration of justice demands that additional taxes should be imposed upon corporate incomes, and it is suggested that this be accomplished by increasing the corporate income tax by a graduated scale, and amendments to this effect will be urged and by other changes affecting their taxes as hereinafter stated.

It is further insisted that there is no reason why corporations of large net income should be given an exemption of \$2,000 because they are entitled, in the first instance, to deduct every legitimate expense before they pay any tax at all, and that this exemption should be repealed. The repeal of this exemption, except probably as to corporations of small incomes, would increase substantially the income tax of corporations.

The minority will propose amendments to the bill increasing the surtax from 32 per cent, as proposed in the bill on incomes of \$66,000, largely increasing the rates on incomes up to and above \$500,000.

The minority also proposes the restoration of the capital-stock tax on corporations, the repeal of which is proposed by the Senate Finance Committee amendment.

In addition the minority proposes to offer amendments reducing the normal tax on incomes below \$15,000.

Also the minority will offer an amendment providing that the exemptions allowed heads of families should be limited to incomes below \$20,000.

The minority will also offer an amendment removing entirely the tax on freight, passenger, and Pullman transportation.

The pending bill as framed is not calculated to promote or protect domestic commerce, or bring about the stimulation of enterprise or increase the profits from which the Federal revenue ought to be raised. It does not equalize the incidence of the tax burden for the people or the business of the country. It does not simplify the computation of the taxes or facilitate the collection of the taxes. It is no improvement over the present law. It does not fulfill the promises that have been held out to the country, nor will it meet the expectation of the people for relief from the discriminations, complications, and exactions of the revenue laws which were improvised to meet the war emergency and were not intended or expected to be permanent. The bill is a poor demonstration of the capacity of the majority party in Congress to deal effectively with this great ques-

tion of the revision and readjustment of our system of internal taxation. The bill does not accommodate the fiscal requirements of the Government. It will merely thrust the question into the field of politics and propaganda for the purpose of convincing Congress that a more effective measure must be framed and enacted. Our revenue system can not be placed upon a permanent and rational basis by a failure to comprehend the factors in the problem and to meet them with resolution and effectiveness. No other action is worthy of Congress in the present state of the country.

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## VIEWS OF A MINORITY.

I am in general accord with the economic sections of the report of the minority in so far as they criticize the proposals of the majority to reduce the supertaxes upon large individual incomes, to repeal the excess-profits tax and the capital-stock tax, to retain the transportation taxes, and to greatly exaggerate the existing disparity between corporation and individual and partnership taxes.

I feel, however, that the recommendations and proposed amendments of the minority will do little more than palliate some of the monstrous iniquities of this bill, without curing any of its fundamental evils.

The correct title of the proposed bill (H. R. 8245) should be "An act to untax wealth and penalize industry and enterprise."

One single principle dominates the entire bill—to lift the burden of war costs and Government extravagances from the backs of individuals and corporations of great wealth and transfer this burden to those whose industry and productivity is essential to the Nation's prosperity. Not only are the supertaxes upon the incomes of multimillionaires cut in half and the taxes upon the profiteering of corporations abolished, but new loopholes are provided by which, in the future, American capitalists can more and more completely escape taxation.

I shall not at this time attempt to deal with all the errors and evils of our fiscal system. In the course of the consideration of the bill by the Senate I shall, however, take occasion to point out some of the more glaring and indefensible defects and demonstrate that if these evils and abuses are corrected and proper measures adopted it would be easily possible to raise the burden from productive industry and individual enterprise and at the same time greatly reduce the taxes upon the individual.

Respectfully submitted,

ROBERT M. LA FOLLETTE.

