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INTERNAL REVENUE

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SIXTY-SEVENTH CONGRESS

FIRST SESSION

ON

H. R. 8245

AN ACT TO REDUCE AND EQUALIZE TAXATION, TO AMEND AND SIMPLIFY THE REVENUE ACT OF 1918, AND FOR OTHER PURPOSES

PART I.

Sept. 1-3, 6-10, 12-17, 30, Oct. 1, 1921

(See Part 2, following)

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INTERNAL REVENUE.

THURSDAY, SEPTEMBER 1, 1921.

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

The committee met in executive session, pursuant to call of the chairman, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Simmons, Gerry, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. The committee is meeting this morning to consider "An act to reduce and equalize taxation, to amend and simplify the revenue act of 1918, and for other purposes." We are about to peruse the act line by line, comparing the act of 1918 with the bill as amended in the House of Representatives and as it came over to the Senate.

Dr. Adams is here, and I will call on the Doctor to make a preliminary statement of his views to the committee.

STATEMENT OF DR. T. S. ADAMS, TAX ADVISER, TREASURY DEPARTMENT.

Dr. ADAMS. The Secretary will appear here next week, at the option of the committee, probably, I think, Thursday rather than Wednesday, if that is convenient.

The CHAIRMAN. The date was fixed for Wednesday, but if Thursday will suit the Secretary better we will change it to Thursday.

Dr. ADAMS. I think he is at your service, Mr. Chairman, but I believe Thursday would be a little better, as he has an unusual pressure of other matters on Wednesday.

The CHAIRMAN. We will make it Thursday at half past 10 o'clock.

Dr. ADAMS. The Secretary at that time will discuss the question of probable expenditures and revenue needs, and the general structure of the tax act, so far as he has any recommendations to make concerning new taxes or fundamental changes in the structure of the House bill, and I should prefer, personally, until he arrives rather to discuss the technical parts of the law, and the reasons for the changes in administrative and similar provisions of the law.

The CHAIRMAN. Dr. Adams, before you go on, did you have any formal hearing of this character before the House Ways and Means Committee?

Dr. ADAMS. There were several formal hearings, and the proceedings have been printed.

The CHAIRMAN. And were they printed for public use?

Dr. ADAMS. They were printed for public use, and can be secured here.

The CHAIRMAN. Were those hearings taken publicly or in executive session?

Dr. ADAMS. Those hearings were taken publicly. When the Secretary appeared, the committee had a full attendance both of the Republicans and Democrats, and it was not an executive session.

The CHAIRMAN. Is the statement you are going to make now a repetition of those hearings?

Dr. ADAMS. I shall not repeat that, Mr. Chairman, unless it seems desirable.

The CHAIRMAN. Later on you did confer with the House committee in executive session, did you——

Dr. ADAMS. Yes.

The CHAIRMAN (continuing). As to the details of this bill?

Dr. ADAMS. I was with the House committee, I think, throughout their entire work on the bill.

The CHAIRMAN. Proceed, Doctor.

Dr. ADAMS. I had understood that I could be of more service to the committee by simply going through some of the reasons for the changes, commencing at the first.

The CHAIRMAN. Do you think we had better proceed to read the bill?

Dr. ADAMS. There could be much judicious skipping. I could call your attention to the points that are really worth going over.

The CHAIRMAN. Do you want to take the bill and read it and skip according to your own judgment?

Dr. ADAMS. I was going to take up the bill, starting with Title I, and call attention to important changes or important problems involved, if that is satisfactory.

The CHAIRMAN. We will be glad to have you do that.

Dr. ADAMS. I would like to raise first the question of what form you want this revenue act to take when finished. The House bill consists of a series of amendments to the revenue act of 1918. That method of dealing with this subject leads to a pretty complicated result. You have the revenue act of 1918 with a lot of changes which apply only for one year, and then further changes which go into effect January 1, 1922, which results in a highly complicated document.

The first problem which you gentlemen should consider is whether you want that sort of a series of amendments to the revenue act of 1918 or whether you want to write a new revenue act.

Senator WATSON. What is your advice as to how we should proceed?

Dr. ADAMS. I hoped you would desire to write a new bill.

Senator MCCUMBER. One of the curses of the present revenue law has been that we had to take two or three revenue laws and examine them all to get the correct application.

Dr. ADAMS. That will be worse.

The CHAIRMAN. Dr. Adams, which is considered the best style from the point of view of artistic excellence, to have an entirely new bill or to amend the old bill?

Dr. ADAMS. I think an entirely new bill would be more artistic.

The CHAIRMAN. Dr. Beaman, I believe, was professor of statutory law in Columbia University, and they probably have some rule or method laid down in that respect.

Dr. ADAMS. He is an artist.

The CHAIRMAN. I simply asked for information as to which would be considered the best style.

Dr. ADAMS. With so many changes an entirely new or rewritten act would be considered the best.

The CHAIRMAN. How could you identify the changes?

Dr. ADAMS. Mr. Walker will have before you in a very few moments a print showing every change made by the House.

The CHAIRMAN. Did you have notes at the foot of the bill?

Dr. ADAMS. Mr. Walker has it printed in different types to show separately the House amendments and the present law.

The CHAIRMAN. Should an attorney or taxpayer read the new bill and want to know wherein it differed from the present law, would he be able to reach a satisfactory conclusion?

Mr. WALKER. So far as that goes, the only way that could be done would be to compare the two statutes; and, so far as the work of the committee is concerned, we have a comparative print made, lining through the matter stricken out of the various sections of the revenue act of 1918, and putting the new matter inserted by the House bill in italics. That print is on the way from the Government Printing Office at this moment.

Senator DILLINGHAM. The taxpayers have a right to demand the simpler form.

Senator SMOOT. And not only that, there is only one thing to do, and that is to rewrite the revenue bill and not to mix it up. This is the worst we ever had.

The CHAIRMAN. Did we not have the same question up in reference to the 1918 act and have to rewrite a large part of it?

Mr. WALKER. You rewrote it from start to finish—an absolutely new act.

The CHAIRMAN. We started with this same system?

Dr. ADAMS. In 1917.

The CHAIRMAN. It passed the House in its amendatory form, did it not?

Dr. ADAMS. Yes.

The CHAIRMAN. We rewrote the bill, did we not?

Dr. ADAMS. The 1918 revenue act passed the House as a new bill; the 1917 act was a very bad illustration of what has been criticized here to-day.

Senator SMOOT. The House rules are such, Mr. Chairman, that perhaps they did by writing the act as they have written it escape some of those questions they wanted to escape. But we have no such rules in the Senate, and if we put this thing in the way it is here we will never get it off the floor of the Senate. There will be untold amendments referring back to the act of 1918, and no telling what would be the result.

The CHAIRMAN. Have you got the bill rewritten, Dr. Adams?

Dr. ADAMS. Not as it passed the House. There should be no delay due merely to rewriting the act; that is comparatively simple, after you have decided what amendments you want.

Mr. WALKER. That can be relatively easily done from the comparative print, which we will have before us in a few minutes.

Senator WATSON. Do you mean by that, Doctor, that you have written an entirely new bill?

Dr. ADAMS. I hope you will write a new revenue bill, and not only write a new revenue bill, but adopt an entirely different form of revenue bill.

There are necessarily in these revenue acts a lot of highly complicated provisions that the average man can not understand, at least on the first reading. I do not see why those highly technical provisions should not be put into separate schedules leaving the body of the statute a rather simple tax law that the average man can understand. Something like this is done in the Brit'sh law; and we have a separate schedule in Title XI, dealing with the stamp taxes.

Senator SMOOT. I move that we write a new bill and repeal all of the other acts, so that when it is passed and becomes a law the business interests of this country and lawyers and everybody else will know just exactly when they have the whole law, when they look at the act when it is passed.

The CHAIRMAN. You make the motion, Senator Smoot, that it is the sense of the committee in a general way that the bill be rewritten along the lines described by Dr. Adams?

Senator SMOOT. Yes.

Senator LA FOLLETTE. That is, that it embody all the new provisions that are to be enforced, so that you will get the meaning? Do I get your idea, Dr. Adams? In other words, so that it will not be necessary to go to other statutes to find out what a citizen has got to do?

Dr. ADAMS. Yes; and also where possible to separate the more difficult and technical provisions.

The CHAIRMAN. We want to pass a new bill that will read concisely.

Senator SMOOT. And so that everybody will know what it is.

The CHAIRMAN. If that is the sense of the committee, Mr. Walker will make a note of it, and Dr. Adams, we will proceed on that declaration. We had the same thing up in the act of 1917.

Dr. ADAMS. Do you want to take up this bill section by section?

The CHAIRMAN. I think we had better do that.

Dr. ADAMS. The first title deals with terms, and it simply provides that the act may be cited as the revenue act of 1921, and that the terms used therein shall have the same meaning unless the context otherwise indicates, as they have in the revenue act of 1918.

The CHAIRMAN. That paragraph you would transcribe to show what the terms were?

Dr. ADAMS. I would simply repeat the terms.

The CHAIRMAN. That is wonderfully better.

Dr. ADAMS. Title II adds to the terms employed in the revenue act of 1918 two new terms—it defines foreign trade and foreign-trade corporations. Before

reading the definition, I might state the general object of this: In this bill "foreign traders" and "foreign-trade corporations" are taxed substantially as foreign corporations and foreign nonresidents. There has been a great deal of discussion about the American corporation and the American citizen engaged in business abroad, practically all of whose business is transacted abroad. There has been particular criticism of the treatment of American nationals doing business in the Philippines. These definitions are introduced to make that plan practical. The term "foreign trader," then, is defined in lines 14 and 15 of page 1 to mean a citizen or resident of the United States or domestic partnership 80 per cent or more of whose gross income for the 3-year period ending with the close of the taxable year, or for such part of such period immediately preceding the close of the taxable year as may be applicable, was derived from sources without the United States, as determined under section 217——

Senator WALSH. Why 80 per cent instead of 60 or 90 per cent?

Dr. ADAMS. In order, Senator, to apply this special procedure only to persons practically all of whose business is done without the United States. An American corporation, if it is doing practically all of its business in China, will pay taxes to us only on the income derived from sources within the United States; on the other hand, an American corporation which has only casual business abroad or which does 10 per cent of its business abroad will pay taxes on all its income derived from the foreign country, but will be given a credit for the income and profit taxes it pays in the foreign country.

Senator CURTIS. It will eliminate the danger of one party doing business in this country and abroad from trying to escape taxation by claiming they have paid it all in the other country?

Dr. ADAMS. That is one of the important features of it.

Senator CURTIS. How does that apply to a case where an importer has done business both in China and in the United States? If he buys in China, his business is in China to that extent, and he imports to the United States. That would be all regarded as business done in the United States?

Dr. ADAMS. No. Rather careful rules are given respecting that in section 217. Income is to a certain extent allocated. If derived from the sale of real estate it goes to the country in which the real estate is situated. But in the case of business of the kind you describe the income is divided between the two jurisdictions. Part of it is deemed to be derived from sources within the United States and part derived from sources without the United States.

Senator LA FOLLETTE. How would it be divided—on what principle?

Dr. ADAMS. That has been largely left to administrative discretion, as will be seen in subdivision (e) of section 217. It is a difficult problem and one with which we must deal, unfortunately, because opinions of the Attorney General have put us in a very unfortunate position. The present law, as you know, taxes foreign corporation and nonresident aliens only on profit from sources within the United States, and the opinion of the Attorney General referred to makes the allocation turn wholly upon the element of sale. If the sale is consummated in the United States, the income is taxable here, and if the sale is consummated abroad the income is taxable abroad. That is the formal opinion of the Attorney General.

Senator LA FOLLETTE. Under this administration?

Dr. ADAMS. Not under this administration.

Senator MCCUMBER. Then if an American corporation establishes a manufacturing plant in China and the product of that plant was sold in the United States the profits of that company are all domestic profits?

Dr. ADAMS. Are all domestic profits. An English corporation which owns timberland in Arkansas cuts the trees, roughly fashioning the timber, and cutting them into rough implement form here, completing the final process of manufacture in Scotland and selling from London, would be held to derive no part of the profit here. The present law is to this effect—that a Canadian corporation, for instance, can set up a factory here, go through all of the business transactions except final sale, and the income will follow the place of sale.

The danger of all that is that it is possible within limits to consummate sales wherever you wish. You can conclude the sale wherever you want to, abroad or here, frequently at your option.

Senator LA FOLLETTE. What is the practice in Great Britain in those cases?

Dr. ADAMS. The practice in Great Britain is similar to that proposed.

Senator LA FOLLETTE. Is there other authority?

Dr. ADAMS. Yes.

Senator CURTIS. There is no end of authority if you shall apply it to a straight proposition.

Dr. ADAMS. It is, in my opinion, an unfortunate opinion of the Attorney General.

Senator LA FOLLETTE. Are we to be bound by that decision?

Dr. ADAMS. Yes; until we change the law.

Senator LA FOLLETTE. The present Attorney General is not bound by that opinion; he can write an opinion reversing it, can he not?

Dr. ADAMS. I think he possibly could; and, moreover, we have had a decision of the Supreme Court in the Underwood Typewriter case since the opinion of the Attorney General in which the court rather disapproved the idea that the entire profits should be made to follow the mere sale and implied that a certain amount of the profit may be allocated to the manufacturing and other activities.

Senator LA FOLLETTE. The whole thing might be created here—have all the value put into it here that labor and art could contribute—and then, just because the sale was made some other place, that the profit is taxable there.

Dr. ADAMS. The British law has a series of arbitrary holdings which make their law a little tolerable; for instance, they are authorized in any case in which the sale is consummated in Great Britain, and they have reason to believe that a fair amount of the profit is not returned, they will simply go in and assume a profit—the profit that ordinarily is secured.

Senator CURTIS. Arbitrarily?

Dr. ADAMS. Arbitrarily. There are business transactions of that kind. We have some complaints from American corporations on that score.

Senator SMOOT. There is real justice for the demand for a change in the law, as I understand it, but that an American citizen could go to the Philippine Islands, and he is taxed as an American citizen on the business done on the Philippine Islands under the American law. The English competitor and all of the foreign countries, universally exempt him from taxation if he does all of his business in the Philippine Islands. Therefore, the Chinaman, the Englishman, the Italian, and all other citizens of all other countries have every advantage in the world of the American business man in the Philippine Islands, and they are going to drive them out of business unless the law changes. But that is where they do all of their business, and have their business established there. That is what has brought about, Dr. Adams, as I remember, the necessity of this change.

The CHAIRMAN. We have had it very prominently up in all the preceding tariff bills.

Senator WATSON. Why do you say a three-year period any more than a two-year or four-year period, if it is fairly representative of the amount of business done?

Dr. ADAMS. We did not want to let a man take this status who is not regularly doing most of his business abroad. There is a leeway; for instance, if the partnership had not been organized—perhaps the man had not been in business; you can make your ruling on the basis of such period as he has been in business. But, in general, we want a three-year period.

Senator WATSON. Do you suggest that that particular title be changed down to the comma to which you have read?

Dr. ADAMS. So far as this one definition stands, in itself it seems to me very good. It is a little cumbersome, but it has been designed to confine itself merely to persons in business. You will notice in the first print we had, lines 5 to 9, two conditions imposed: First, that 80 per cent or more of the gross income for the three-year period was derived from sources without the United States; second, that more than half of the man's gross income shall have been derived from the man's active conduct of business. That has been inserted to prevent mere investors taking advantage. That was very bitterly fought in the House; and that second condition was put in there to prevent, for instance, persons living over here investing in French or Danish or Swiss bonds and getting a large percentage of income from that and claiming exemption. So that in order to prevent that this method of taxation may be followed by all persons 50 per cent of whose gross income shall have been derived from the active conduct of business; and I think that is very necessary. The thing would be open to abuse if some such condition were not imposed.

This other will give you the present revenue bill, and the first new thing we come to on the subject we are now discussing is found on page 5, lines 13 to 23, and the following page.

Similarly the term "foreign-trade corporation," at the bottom of page 5, means "a domestic corporation, 80 per cent or more of the gross income of which, for the three-year period ending with the close of the taxable year (or for such part of such period as the corporation has been in existence), was derived from sources without the United States, as determined under section 217, and 50 per centum or more of the gross income, of which for such period or such part thereof, was derived from the active conduct of a business without the United States."

Of course, whether you want these definitions depends upon whether you finally indorse this scheme of taxing foreign traders only on income derived in this country.

Senator McLEAN. There is a provision in the bill, is there not, where the taxes under similar conditions are reciprocal?

Dr. ADAMS. That refers to another thing. The personal credit is under existing law given to nonresident aliens only when the country to which they belong gives a similar credit to citizens of this country.

Senator McLEAN. Would it not be claimed that a similar provision should apply where a corporation is doing business in a foreign country?

Dr. ADAMS. I do not think so, Senator. This provision does not apply to the nonresident alien.

Senator McLEAN. There is at the present time no reciprocal understanding or provision with regard to aliens doing business?

Dr. ADAMS. Only in the case of the resident alien. The nonresident alien is and always has been taxable only on his income derived from this country. What is being done is to set aside a certain group of Americans who do all of their business outside of the country and virtually treat them as foreigners.

Senator McLEAN. But it applies to residents not United States citizens?

Dr. ADAMS. Yes.

Senator WALSH. Suppose Americans in the Philippine Islands doing business there now have to pay taxes like all other business concerns, foreign and domestic, to the Philippine Government, and also have to pay, as American citizens full taxes to the American Government?

Dr. ADAMS. That is so.

Senator LA FOLLETTE. Doctor, can you cite that decision you spoke of in the Supreme Court?

Dr. ADAMS. That was the case of the Underwood Typewriter Co., and I do not think it has been reported yet. I will get it for you, Senator.

By the way, none of our American States, which has income taxes, follow the provisions that the income shall follow the sale.

Coming to dividends, the definition of "dividends" needs some correction, by reason of a decision of the Supreme Court in the stock-dividend case, and by reason of other things.

On page 6, lines 11 and 12, you will notice some changes made in the definition of dividends. Perhaps we had better read that:

"That the term 'dividend,' when used in this title (except in paragraph (10) of subdivision a of section 234 and paragraph (4) of subdivision a of subdivision 245)"—and those exceptions refer to insurance dividends where the dividend received does not mean a corporate dividend of an ordinary kind.

Senator WALSH. Why should there not be something in there to indicate, rather than compelling, a man to look up those sections to find out what that means? Why should there not be a note referring to insurance or something of the kind?

Dr. ADAMS. We might clear that up by saying "except insurance dividends"; possibly something could be done along that line.

Senator WALSH. My suggestion was a hint be given in the language used of the nature of these subdivisions. They relate to insurance dividends, Dr. Adams says, and by insert'ng in there that they refer to insurance dividends it would not be necessary for the ordinary taxpayer to refer to those divisions to find out what was meant.

Senator SMOOT. If you did that you would have to insert the whole title here, and that has never been done.

Senator WALSH. Not necessarily.

Senator CURTIS. You can do that the way you do in a court—note it.

Dr. ADAMS. You could say something like "except insurance dividends, as referred to in paragraph 10," and so on.

Senator WALSH. In other words, a taxpayer would have to look up those sections in order to make out his return and that would only apply to one-tenth of 1 per cent.

Dr. ADAMS. That is true. That italicized matter in line 11 is simply another reference to insurance companies and has no particular significance except that.

"That the term 'dividend' when used in this title, except in paragraph 10 of subdivision a of section 234 and paragraph 4 of subdivision a, section 45, means any distribution by a corporation."

Striking out the words "other than a personal service corporation."

One of the changes which the House made, and I think very properly, was to abolish the special method of taxing personal-service corporations. Personal-service corporations are corporations which have very little capital and whose income is derived by the personal activities of the owners of the stock, and because they have very little capital we have exempted them from excess profits since 1918. If the excess-profits tax is abolished, as the House decided, it of course becomes necessary to make a category of personal-service corporations. It was very necessary under the excess-profits tax, because professional men—engineers, accountants, and so on—could not pay a tax entirely based on invested capital. But the status of the personal-service corporation is very difficult. Its legality is highly questionable since the decision of the Supreme Court in the stock-dividend case, and the sooner we can get away from that special segregation of personal-service corporations, which is both difficult and of doubtful validity, the better.

The CHAIRMAN. Did that special segregation account for any large income to the government?

Dr. ADAMS. No; it was a relief measure purely.

The CHAIRMAN. I know it was a relief measure to the parties affected, but did it embrace any amount of revenue?

Dr. ADAMS. No; not a large amount. Of course, it was a crucial matter to the corporations affected, but only about $10,000,000 were received from personal-service corporations. Most of the businesses of that kind are in partnership form.

The CHAIRMAN. I remember we had an awful trouble with it.

Dr. ADAMS. Reference to the personal-service corporations should be stricken out and the special method of taxing them abandoned if you abolish the excess-profits tax.

Senator SIMMONS. And they will pay dividends like any other corporation?

Dr. ADAMS. Yes; while at the present time the personal-service corporation is taxed as a partnership. Its entire income at the end of the year is considered as distributed among its stockholders and taxed to the stockholders as the income of a partnership would be, consequently the dividends when paid went tax free, because they had already been taxed in entirety to the corporation.

Senator MCCUMBER. Then why should we not consider it as a partnership?

Dr. ADAMS. We are doing that now, Senator, but we want to change that for this reason—I do not know whether you are familiar with the Collector *v.* Hubbard case or not.

Shortly after the Civil War corporations were taxed on their earnings, and it was provided at that time that if they were not distributed they should nevertheless be taxed to the stockholders just as a partnership is now taxed. That went to the Supreme Court in the case of Collector *v.* Hubbard, and the case was decided, as I recall, in 1870. When the stock dividend case came up, the Government defended the legality of taxing stock dividends on the ground that all of the income of a corporation, whether distributed or not, might be taxed to the stockholders in accordance with that case of Collector *v.* Hubbard.

In the stock dividend case, as I read it, and as most lawyers read it, the Supreme Court virtually reversed the decision in the case of Collector *v.* Hubbard and said that since Pollock *v.* Farmers' Loan & Trust Co., Collector *v.* Hubbard was not a precedent. They plainly said that you can not tax undistributed profits of a corporation to its stockholders. That is exactly what we are doing with the personal-service corporation.

Senator MCCUMBER. Suppose we treat them entirely as partners, and there is no corporation tax whatever levied against the personal-service corporation, but the earnings of the partners as such, without any other tax, would be taxed the same as a partnership. Do you think that would be held legal?

Dr. ADAMS. That is just what I think the Supreme Court said you could not do. They say that the earnings of the corporation are not in any vital sense earnings of the stockholders, and you can not tax them to the stockholder until he gets them.

Senator McCUMBER. Then, how are you going to tax the personal-service corporation?

Dr. ADAMS. We have been doing it. It is a question of matter of relief; and later on in this act you will see we have a validating provision—the House adopted it, and I regard it as highly important—that if the present method of taxing personal-service corporations is declared invalid they shall be subject to the regular corporation tax; that is in the present bill later on.

Senator SIMMONS. Doctor, my recollection on that decision was that if they held a stock dividend was declared it was not subject to the tax which we had imposed on stock dividends, and I think that is about as far as they went in that case.

Dr. ADAMS. You see, Senator, this case I am speaking to you about was put flatly before them. We had taxed after the Civil War all of the dividends to stockholders, whether distributed or not. That had been sustained in the case of Collector *v.* Hubbard.

Senator SIMMONS. When you speak about the Civil War you mean the war of 1864?

Dr. ADAMS. Yes, sir; it was after the Civil War, some time in the seventies.

The CHAIRMAN. How long was that in force?

Dr. ADAMS. Seven or eight years.

The CHAIRMAN. They taxed the whole surplus of the corporation?

Dr. ADAMS. Absolutely.

The CHAIRMAN. Our attention was not called to that fact.

Dr. ADAMS. I suppose not.

The CHAIRMAN. I do not remember it.

Senator SIMMONS. They held first that we could not impose a tax on a stock dividend; that is what they held. We attempted to do it. We provided a case of a declaration of stock dividends to the stockholders that they should become responsible for the tax just as any other cash dividends?

Dr. ADAMS. Yes.

Senator SIMMONS. The Supreme Court said that was unconstitutional and void. Now, then, with reference to the personal service corporation, in the last act, as I remember it, we put them upon a parity with partnerships.

Dr. ADAMS. That is right.

Senator SIMMONS. That is to say, at the end of a year each partner was required to pay a personal tax as an individual. An individual tax contains part of the profits for that year, and we carried that principle on and applied it to personal service corporations. The courts have never said that that was illegal.

Dr. ADAMS. Not at all, but I fear the reasoning in the stock-dividend case is going to make them say it is illegal.

Senator SIMMONS. Not when we have declared that kind of a corporation of a partnership.

Dr. ADAMS. They say you can not do it. They say you can not tax the undivided dividends to its stockholder. The stockholder has not got it, and you can not enforce collection, because it is not his until legally separated and turned over.

The CHAIRMAN. And it is liable to be wiped out any day of the year.

Senator McCUMBER. That is true of a corporation. I do not know why a partnership should not be taxed for something he has not drawn out.

Dr. ADAMS. But the member of the partnership is the owner.

Senator McCUMBER. He is the owner, but it does seem to me there ought to be some way of reaching that.

Dr. ADAMS. You would want to abolish this language dealing with personal service corporations, whether or not it is likely to be declared unconstitutional. The definition "personal service corporation" is difficult.

Senator SIMMONS. To my mind the only way to treat personal service corporations is to treat them as a partnership, and I can not believe that the Supreme Court would say that we had no authority to treat a personal service corporation as a partnership.

Senator SMOOT. As long as they are exempt from excess-profits tax, and if we are to abolish the excess-profits tax, what is the necessity of treating them any other way?

Senator McCUMBER. Whatever your tax is upon the corporation, it will not be anywhere near equal to the surtax of a light earning by a partnership.

Senator SMOOT. It will be if it is 12½ per cent, and then it is distributed.

Senator McCUMBER. No. Suppose you take two partners who have earned $100,000 each, a total of $200,000. What is your last bracket? You run up to 40 per cent or more, whereas your personal service corporation can not run it over 12 per cent upon their profits.

Senator SMOOT. But it is distributed afterwards and paid them.

Senator McCUMBER. Supposing it is not distributed. They are not paid anything, and there ought to be a way where you can reach the same where one is paid as much as another.

Senator SMOOT. We have always held 4 per cent would make it equal all around; certainly 10 per cent will. The only discrimination I can see in treating personal service corporations as a partnership is that the corporation earnings are earnings from property. It is what we call "unearned dividends"—unearned income; while the earnings of a personal service corporation is an earned dividend. It is the earnings of personal service; and ordinarily it has been felt, although we have never provided for it, that there ought to be a differential in favor of the income that comes from personal service or in favor of an earned as against unearned dividend.

Senator McCUMBER. In all the partnerships both partners give their time, and in addition they have to furnish the capital. Here are two partners with a capital of, say, $1,000,000 put into the business, and they earn $200,000. You will tax them for the entire $200,000, even though they took $1,000,000 to earn it. While here are a few persons who constitute a personal service corporation. They may have put up $500 worth of furniture and books in their establishment, and the rest is their service, and they make $200,000, although there is not a penny invested. You make the partnership pay ten times as much before you get through as you did the personal service corporation, and there is something everlastingly wrong in that.

Senator SMOOT. That argument would apply more particularly to large corporations than it would to personal service corporations.

Senator McCUMBER. Where we can put those two classes on a parity.

Senator SMOOT. In this case, if we had it 12½ per cent, we would put on a parity all corporations. Of course, there may be a case now and then where it would not; but it would more than do it on the average—a great deal more than do it.

Senator McCUMBER. I do not think it will do it, and I think I can establish it even to your satisfaction.

Senator SMOOT. You can take a suppositious case and establish it, but you can not do it on the business of the country.

Senator SIMMONS. The reason we did not make it contribute to the excess-profits tax as we did other corporations, was simply because as a personal service corporation there was no way to retain dividends; everything was distributed. In the other corporation they distribute part and retain part, and only a part therefore became subject to the income tax.

Senator SMOOT. It was partnerships and personal service corporations which had a flat tax. The normal tax was different, and that difference in those two taxes was supposed to make them equal. I do not believe 4 per cent made it even, but I have no doubt but what 10 per cent would do it.

Senator McCUMBER. On the average it will. But you and I when we pay taxes have nothing to do with averages. We pay what we earn, and it is perfectly fair that everybody should pay whatever the rate may be in his earnings.

Senator SIMMONS. What we did before was to try to equalize it.

Senator McCUMBER. We did it before, but undoubtedly it is unconstitutional.

Senator SIMMONS. We exempted the partnership as such from the excess-profits tax and made the partner pay the full income.

Senator McCUMBER. Contributed or not?

Senator SIMMONS. Yes; and in that way we felt we had equalized the situation as between the corporation and the partnership. We worked it out that we found that if a partnership had to pay an excess-profits tax it would have to pay more than a corporation, that it would be unequal; and therefore we equalized by exempting from excess-profits tax; and now if we do the same thing as to personal-service corporations if we declare they should pay as a partnership. Now, if we abolish the excess-profits tax, that adjustment of the equality falls to the ground, and you have another inequality which will work against a partnership and against the personal-service corporation.

Senator SMOOT. There is an equality in certain cases, particularly when the rate of gain is exceedingly high; there certainly is equality.

Senator McCUMBER. Let us suppose a personal-service corporation earns $200,000. You tax then 10 per cent; that is $20,000. Suppose the corporation that has invested $1,000,000 in its business earns $200,000. What is it to pay under your system here? It would pay five times as much at least.

Senator SMOOT. There may be five partners and there may be only two.

Senator McCUMBER. I am referring to a case of two, and they earn $100,000 each. Under this bill on the earnings of $100,000, what does each pay, Doctor?

Dr. ADAMS. Thirty-one percent.

Senator McCUMBER. Each of them pays 31 per cent on $100,000. There is the 31 per cent as against 10 per cent.

Senator SIMMONS. Is it not perfectly clear that if we abolish the excess-profits tax and impose an income tax upon corporations under the present plan that that would work very greatly to the advantage of the partnership?

Dr. ADAMS. It depends entirely on the size of the income; it might be under and it might be over. You see, the rate on corporations is 10 per cent plus the excess-profits tax. If the shares of the partners were very large they would be more harshly dealt with under the income than excess-profits tax.

Senator SIMMONS. I am eliminating the excess profits.

Dr. ADAMS. Abolish that and the same condition obtains. It depends on the size of the shares. A partner who gets $100,000 income, if my figures are right, is obviously paying a good deal more than would be paid under a corporation tax. On the other hand, the corporation has capital-stock tax to pay, and if it does not distribute its income its surplus is taxed in addition. We simply have a condition of possible inequality either way.

Senator McCUMBER. I am considering the case of personal service corporations. They stand on exactly the same footing so far as business is concerned, as the ordinary partner?

Dr. ADAMS. Yes, sir.

Senator McCUMBER. And the same rule will not apply to the general corporation that has to give its bonds and has capital stock on its capital invested.

Dr. ADAMS. There are two cases I think you want to consider.

Senator McCUMBER. Here are two doctors. They join together and form a partnership, and they earn $100,000 a year. Here are two men who join together and form a corporation. I do not want to see the law left so that the two partners will have to go and incorporate and by doing that they may avoid two-thirds of their tax.

Senator SMOOT. In that example you cited, the man who formed the corporation with two stockholders would be to a disadvantage under this law. But if you had 100 stockholders, perhaps it would be different.

Senator SIMMONS. It is a fact that public service corporations and these partnerships are generally composed of two men, especially the partnerships.

Senator McCUMBER. The personal service corporations are generally the same thing.

Senator SIMMONS. The corporation making about the same income on the average would have a score of stockholders, and the money would be divided up among that score of stockholders, and they would have to pay especially for surtaxes, which would be very small compared with the amount of income that the two or three members of a partnership or personal service corporation would have to pay. It is just a question of the division of the income.

Senator SMOOT. I agree with Dr. Adams, and I will add to what the doctor said that perhaps 80 per cent of all the corporations in the United States to-day would not have any advantage whatever over the proposition if they paid 10 per cent on their profits, straight out, as against a partnership doing the same business. But in cases where there are extremely high profits——

Senator SIMMONS (interposing). How can you say that if the corporation has a multitude of stockholders and the partnership has only two or three, especially if the corporation is permitted to carry a large part of its earnings and surplus can not distribute at all and not pay any tax?

Senator SMOOT. There is not so very much of that.

Senator SIMMONS. Is there very much undistributed surplus? What is the amount of undistributed surplus in this country, Mr. McCoy? My impression is, as it was developed in the discussion, that if the income was distributed it would add enormously to the revenues of the Government.

Senator SMOOT. Yes; and destroy the business.

Senator SIMMONS. I am not talking about that. I am not talking about whether it is the best thing to do or not; I am talking about the fact that a

large part of the income of corporations under the present law is not distributed except in the shape of stock dividends.

Senator SMOOT. There are not very many stock dividends.

Senator MCCUMBER. You might add that where there is a partnership business the partnership can not draw everything it earns. It has to leave it in the business, just exactly the same as the corporation, and it pays taxes in addition.

The CHAIRMAN. Many of the service corporations have very large capital that they use, such as architects. They need possibly several hundred thousand dollars to invest in plans and drawings.

Senator MCLEAN. The Doctor was going to explain the difference between a personal service corporation and a partnership, but he has not had the opportunity yet.

Dr. ADAMS. I think you gentlemen are discussing a somewhat different problem.

Senator SIMMONS. I know we are, Doctor; but I think it is well for us to understand the situation.

Dr. ADAMS. I think it is very necessary.

The CHAIRMAN. We will have it up in the Senate anyhow, and we ought to understand it.

Dr. ADAMS. You were discussing the problem, really, of the difference between the individual tax and the corporation tax, and the discrepancies that might result. Senator McCumber and Senator Simmons were pointing out that——

Senator SIMMONS. I was trying to point out that we adjusted the differential in the last bill by relieving the corporations of the excess-profits tax. Now, if we should abolish the excess-profits tax that same discrepancy or discrimination would arise to trouble us again, and we should have to adjust it probably in some other way.

Dr. ADAMS. If you want to do what Senator Simmons and Senator McCumber are talking now, you want to extend your definition of a personal service corporation. [Reading:]

"The term 'personal service corporation' means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor."

A personal service corporation to-day is confined to corporations practically without capital. If you want to equalize corporation and partnership taxation you do not want that phrase in there about capital, because men in partnership have an enormous capital.

If you want to go over to the scheme of taxing partnerships and small corporations on the same basis, then you want an entirely different definition of a small corporation or a close corporation.

The CHAIRMAN. I do not think that you can separate a partnership and a personal service corporation in a great many cases.

Dr. ADAMS. Except the legal aspects of it.

I think we have got to come back to the constitutionality of this method of dealing with a personal service corporation, and if you will let me read what the Supreme Court said about this——

Senator MCCUMBER. I read that over, and I came to the same conclusion that you did. I think you are right.

Dr. ADAMS. I am interested to hear you say that, Senator.

Senator SIMMONS. I have not read it.

The CHAIRMAN. Let Dr. Adams read it.

Dr. ADAMS. The Supreme Court laid down as its doctrine the following statement:

"The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company still remains the property of the company and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the sixteenth amendment."

That was the court's fundamental doctrine. It takes up the case of Collector v. Hubbard, the case which I referred to before. The court goes on to say:

"The Government relies upon Collector *v.* Hubbard, which arose under section 117 of the act of June 30, 1864, providing that 'the gains and profits of all companies, whether incorporated or partnership, other than the companies specified in this section, shall be included in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise.'"

The court goes on to say:

"The court held an individual taxable upon his proportion of the earnings of the corporation prior to determination."

In regard to the case of Collector *v.* Hubbard the court says this:

"In so far as this seems to uphold the right of Congress to tax without apportionment a stockholder's interest in accumulated earnings prior to dividend declared, it must be regarded as overruled by Pollock *v.* Farmers' Loan & Trust Co."

That is an 1895 case.

Senator WATSON. Can you tell us, briefly, what that 1895 case involved?

Dr. ADAMS. The 1895 case held that an income tax was for practical purposes a direct tax. It could not be levied without apportionment. That was corrected by the 1916 amendment, but the court, going on to consider the argument of whether it was corrected for this purpose by the 1916 amendment, says, "No; not at all."

I personally should like to see some method of taxation by which partnerships and corporations could be treated exactly alike.

Senator MCCUMBER. Could you not make this distinction: Take corporations in general, where the capital does not exceed 10 per cent, we will say, of the net earnings; they shall be taxed upon a basis practically the same as partnerships. In other words, the rates will be practically the same, or 10 per cent less, if you want it, than the rate would be for a partnership. Could it be met that way?

Dr. ADAMS. I do not regard that solution as practicable.

Senator MCCUMBER. Could you make some definition, then, which would apply generally to corporations, but the rate would simply be higher to a class of corporations whose profits were enormous compared with the investment.

Senator WATSON. Does your proposition involve the taxing of undistributed profits of corporations?

Senator MCCUMBER. No; but it would involve a tax on the corporation for doing business that would be so much higher in case of personal-service corporations that they would pay substantially the same as corporations.

Senator SMOOT. You would bring in the question of capital stock again, with all the difficulties attending it.

Senator MCCUMBER. I did not say capital stock. I said investment. It did not have any reference to capital stock.

Senator SMOOT. That would bring everything in, then, patents and everything else.

Senator CURTIS. The department has considered this question. Have they any suggestion to make as to a remedy at all?

Dr. ADAMS. The department is largely, for practical reasons, very anxious that the separate and peculiar taxation of personal-service corporations be abandoned. It is difficult. If you will read it over you will see that it is difficult. To treat them as partnerships raises great difficulties, and we are all the time beset by the fear that the first case that goes to the courts will result in the whole thing being overturned.

Senator CURTIS. That is wholly on the income proposition.

Dr. ADAMS. They ought to go back and take their status as corporations. The difficulties, however, will remain just as Senator Simmons and Senator McCumber pointed out. If you want to equalize corporation and partnership taxation, you have got to do it by more sweeping measures than by the use of the personal-service corporation. It must be done by something like this, for instance, that all corporations having less, we will say, than 10 stockholders where the principal stockholders are actively engaged in the conduct of the business shall be treated as partnerships and pay taxes as such.

There you would still have your constitutional difficulty, but you would get rid of the administrative difficulty of dealing with this rather artificially defined group of personal-service corporations. If you gentlemen had to administer the law, you would know what that means. It is not very difficult at the present time, because in most cases the corporation is anxious to be classified as a personal-service corporation. If you mean to try the plan which

Senator Simmons and Senator McCumber have in mind, I should make the class of corporations affected more sweeping, more comprehensive, and less artificial. Otherwise place all corporations together on the same basis. Very good lawyers differ as to whether the method of personal-service tax will be upheld by the courts.

Senator SIMMONS. Did I understand you to say that the department very strongly desired that personal-service corporations shall be treated as other corporations?

Dr. ADAMS. Provided the excess-profits tax is abolished.

The CHAIRMAN. Ought not the committee to take up that question at an early date?

Dr. ADAMS. That recommendation is wholly dependent upon what you do with the excess-profits tax. You can not tax personal-service corporations under the excess-profits tax. They have no capital, and the excess-profits tax depends upon capital.

Senator MCCUMBER. I wish you would try to see if you could work out that last suggestion you made about extending the definition and see if we can meet the personal-service corporation and the partnership and bring them together.

Senator SMOOT. I know of firms with less than 10 stockholders where the two principal stockholders in the corporation would receive just the advantages, with the exception of a share or two of stock held by other stockholders, and be taxed as personal service corporations are. It would be unfair to every other institution doing the same kind of business in the great city of Chicago.

Senator SIMMONS. Are you referring to the Sears-Roebuck concern?

Senator SMOOT. No. Some of the largest concerns that there are.

The CHAIRMAN. Some of the largest in the country.

Senator SMOOT. Yes.

Dr. ADAMS. Many of the large private bankers are partnerships. The largest cotton-exporting firm in the country is, I am told, a partnership.

Senator SMOOT. Yes; some of the largest cotton importers in the world are partnerships.

The CHAIRMAN. John Wanamaker was only incorporated very recently.

Senator SMOOT. It would not take three months to go right back into it.

The CHAIRMAN. We put a special provision in the last bill permitting them to become incorporated.

Senator SIMMONS. We attempted to relieve them by a special provision in their favor, allowing them to be incorporated.

Dr. ADAMS. Yes. Taking up page 6, line 12, there is no substantive change, gentlemen, made in the first paragraph, subdivision (a) of the dividend definitions, page 6. The changes that are made there relate to the personal-service corporation. That is, in substance, handled in subdivision (b), on page 7, with a slight change of phraseology—suppose I read it all?

The CHAIRMAN. It is a very important paragraph.

Dr. ADAMS (reading):

"For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913 but any earnings or profits accumulated prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed."

There is nothing new in that, gentlemen, at all, except this point: You notice that the paragraph starts out with the words "For the purposes of this act every distribution is made out of earnings or profits" to the extent that they have them.

The present law says "any distribution shall be deemed to have been made." The department has been troubled about the meaning of the word "deemed." Taxpayers insist that that word gives the department some discretion to "deem" a distribution a dividend or not to "deem" it, as the circumstances may warrant.

The department sees no reason why it should have any discretion there. We want you to lay down a flat rule that for the purpose of this act their distribution is made out of earnings or profits, provided they have got them. I think that is a sound rule, and I see no reason why it should not be done. If that change is made it will save us labor in thought and time.

Senator WATSON. Have you been exercising a discretionary power in that respect?

Dr. ADAMS. No, sir; but we have been subjected to much pressure to exercise discretion. We do not believe that Congress meant that we should exercise discretion in that matter.

Senator WATSON. You have been acting as if "deemed" were——

Dr. ADAMS. As if "deemed" meant "is."

That is the only change which the House made in this paragraph.

Coming to subdivision (c), the language making stock dividends taxable is stricken out. It reads in the present law:

"A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed."

That is invalid and is not being enforced. Then, reading further:

"Amounts distributed in the liquidation of a corporation shall be treated as in part or in full payment."

That is the sole change made in the law at that point, to recognize what is known as partial liquidation distribution. Further:

"And any gain or profit realized thereby shall be taxed to the distributee as other gains or profits."

There is no change there. The question arises as to whether there may be a partial liquidation distribution, and there is some doubt about it. At a later time, when you gentlemen want to consider amendments, I should like to raise some questions there.

The CHAIRMAN. Mark that to go back to, because that is a very important provision.

Dr. ADAMS. Subdivision (d), page 7. The part that is stricken out relates to stock dividends; and because it relates to stock dividends in the past, it is no longer necessary.

Senator MCCUMBER. You have a new subdivision (d)?

Dr. ADAMS. We have a new (d), on page 8, line 9, reading:

"For the purposes of this act, a taxable distribution made by a corporation to its shareholders or members 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."

We want Congress to give us some rule as to when a dividend is taxable. You have a number of different dates there. A dividend, we will say, is declared by a corporation on December 15, payable December 28. The checks actually are signed on the 29th, and they reach the stockholders on the 1st, 2d, 3d, 4th, 5th, and 10th of January. Owing to the fact that so many dividends are paid toward the close of the year when rates frequently change, this becomes a very important and rather crucial matter, and we think that for uniformity the best date is the date when the dividend is absolutely the property of the stockholder of record——

The CHAIRMAN. Is that phrase "made subject to their demands" a proper phrase?

Dr. ADAMS. I think that is the best phrase you could get. That has been adopted after a good deal of study—"unqualifiedly." A corporation can not recall it; they can not rescind the dividend. There comes a time when the corporation can not recall the dividend; it is beyond their power. When that happens and the stockholder can get it when he wants to, that should mark the time when the money absolutely passes from the corporation to the stockholder.

Senator SMOOT. There are companies which declare a dividend for the whole year, in December, payable quarterly, beginning with the 1st day of January. Under this provision you would have to tax the whole of the dividends for the following year?

Dr. ADAMS. No; not until the quarterly payments become——

Senator SMOOT. Supposing the company declares its dividend of 10 per cent on the 22d or 23d of December; and that is not payable until the following year.

Senator WATSON. This says "unqualifiedly made subject to their demands."

Senator SMOOT. Yes; after the dividend has been declared, and you would have to pay it.

Senator MCCUMBER. It may not be payable until six months.

Senator SMOOT. Under this provision they would have to pay a tax rate at once, and make a report on March 15.

Dr. ADAMS. I do not think so, Senator.

Senator CURTIS. It means just the opposite of that, I think. You pay the tax in 1921, and they would get your December, 1921, check in January, 1922.

Senator SMOOT. That is not the way it is worked, or else I do not understand it.

For instance, we have to make out our tax returns for the year 1920 by March 15. A bank declares a dividend on the 22d of December, 1920, and under this provision it would have to go into a return made on March 15, 1921.

Senator CURTIS. I do not think that is what it means.

Senator MCCUMBER. Why would it?

Senator SMOOT. That is what it says.

Dr. ADAMS. We do not believe that that man should be taxed on the mere declaration of a dividend.

Senator SMOOT. It is not a declaration. They set it aside as a dividend. I can show you in 75 per cent of the cases that the banks are declaring dividends in December for the following years, and they are held as dividends undistributed.

Dr. ADAMS. Do you not want to tax them in order to get it in the following year? That is what this aims to do.

Senator CURTIS. It ought to be definitely written so that it does mean that.

Senator SMOOT. It is now fixed so that it is paid in the following year.

Senator CURTIS. Oh, no.

Senator SMOOT. I know my returns are that way. If my bank declares a dividend on the 22d of December, 1920, for the following year—and that has been going on for 20 years—I pay just as much tax, because each year I pay the tax.

Senator CALDER. You are talking about something entirely different.

Senator MCCUMBER. You do not pay it in December, do you?

Senator CURTIS. I think we can change the wording.

Dr. ADAMS. The wording is rather important. What we want to do is this: We want to make the tax as of 1921, because we can not get it until 1921.

Senator MCCUMBER. That is what you have done under this amendment.

Dr. ADAMS. That is what we have tried to do here. There are all kinds of differences in the date of the declaration, the date on which it is actually paid, and the date the taxpayer gets it.

Senator SMOOT. That is what you are doing under the law to-day.

Dr. ADAMS. We wanted you to confirm the present practice. Do you want to change that practice?

Senator SMOOT. No; I do not want to change it.

Dr. ADAMS. Very well.

Senator SMOOT. I understood you to say that they would be taxed in the year the dividends should be declared?

Dr. ADAMS. Oh, no; I think that would be wrong.

Senator MCCUMBER. The amendment is just exactly the opposite of that.

Senator SMOOT. It is just exactly what it ought to be, then.

Senator MCCUMBER. According to the Supreme Court decision, you could not tax it in the year in which it was declared unless it was subject to his control.

Dr. ADAMS. I think you are right about that.

Subdivision (e), which you have here, is a provision which has no meaning, except in connection with the excess-profits tax, and it is repealed only as of January 1, 1922, in the House bill.

Senator SMOOT. If we make the excess-profits tax retroactive, of course, we would have to have this section in, in modified language.

Dr. ADAMS. It is really in the House bill until the end of this year. If you keep the excess-profits tax on the same basis as the House bill you want this to stay in for a year. If you keep the excess-profits tax for good you want this to stay in for good——

Senator MCCUMBER. In other words, in 1921 excess-profits taxes will be collected?

Dr. ADAMS. Yes, sir; it will take care of that in accordance with what you gentlemen do with reference to the excess-profits tax.

The CHAIRMAN. Why did the House change its policy in this connection?

Dr. ADAMS. It was a matter of policy, sir.

The CHAIRMAN. A matter of revenue?

Dr. ADAMS. Partly.

The CHAIRMAN. There has been a sudden change, and I must confess that I do not know why the change was made.

Dr. ADAMS. The House committee originally decided to recommend that the profits tax be repealed as of January 1, 1921, but the Republican caucus voted to keep it for a year, as I understand, in the belief partly that the excess-profits tax would be a heavier tax on the larger corporations than an additional income tax. My own feeling is that this opinion is wrong. The larger corporations of the country are, in my opinion, on the whole, relatively over-capitalized, and that the larger corporations are getting from under the excess-profits tax.

The CHAIRMAN. Has there been any estimate made of the differences in the revenue?

Dr. ADAMS. Mr. McCoy has made estimates on that.

The CHAIRMAN. Can you give it to the committee very briefly, in a word?

Mr. MCCOY. I have a statement here, Senator.

Senator WALSH. Let it be inserted in the record.

Mr. MCCOY. I have made an estimate for the calendar year 1922 and for the calendar year 1923. The total income under the present law estimated for the calendar year 1922—that is, the total from this bill—in internal-revenue taxes——

Senator SIMMONS. You mean the Fordney bill?

Mr. MCCOY. Under the present law the total would be $3,390,000,000; and under the bill as it passed the House—the Fordney bill—$2,960,000,000. That is for the calendar year 1922.

For the calendar year 1923, $2,644,000,000. I have itemized them.

(The statement referred to and submitted by Mr. McCoy is as follows:)

Estimated revenue.

CALENDAR YEAR 1922.

Source of revenue.	Present law.	H. R. 8245.	
		As reported to the House.	As passed House.
Income tax:			
Individual	$900,000,000	$740,000,000	$830,000,000
Corporation	400,000,000	556,250,000	400,000,000
Profits tax	450,000,000	.....	450,000,000
Back taxes (income or profits)	300,000,000	300,000,000	300,000,000
Miscellaneous internal revenue total	1,340,000,000	1,025,920,000	980,490,000
DETAILS.			
Estate tax	150,000,000	150,000,000	150,000,000
Transportation	262,000,000	.....	.....
Telegraph and telephone	28,000,000	28,000,000	28,000,000
Insurance	19,000,000	12,700,000	.....
Alcoholic spirits, etc.	75,000,000	75,000,000	75,000,000
Nonalcoholic beverages:			
Cereal beverages	19,000,000	12,000,000	18,000,000
Carbonic acid gas	.....	2,000,000	2,000,000
Soft drinks, fruit juices, sirups, etc	41,000,000	12,000,000	12,000,000
License tax on dealers	.....	10,000,000	.....
Tobacco	255,000,000	255,000,000	255,000,000
Admission and dues	98,000,000	98,000,000	98,000,000
Section 900:			
(1), (2), (3), automobiles, trucks, parts, etc	115,000,000	115,000,000	115,000,000
(4) Musical instruments, etc	12,000,000	12,000,000	12,000,000
(5) Sporting goods, etc	4,000,000	2,000,000	1,000,000
(6) Chewing gum	1,300,000	1,300,000	1,300,000
(7) Cameras	800,000	800,000	.....
(8) Photographic films, and secs. 901 and 906	6,000,000	6,000,000	0,000,000
(9) Candy	22,000,000	14,000,000	14,000,000
(10), (11), (12) Firearms, knives, etc	4,000,000	4,000,000	4,000,000
(13) Electric fans	280,000	.....	.....
(14), (15), (16), (17), (18) Thermos bottles, cigar or cigarette holders and pipes, automatic slot vending machines, liveries and livery boots, hunting and shooting garments, etc	800,000	800,000	800,000
(19) Fur articles	9,200,000	4,600,000	4,600,000
(20) Yachts and motor boats	520,000	520,000	300,000
(21) Toilet soap, etc	2,100,000	2,100,000	.....
Section 902, art works	1,200,000	1,200,000	600,000
Section 904, luxuries	20,000,000	5,000,000	5,000,000
Section 905, jewelry, etc	25,000,000	25,000,000	25,000,000
Section 907, perfumery, cosmetics, proprietary medicines, etc	6,000,000	14,000,000	.....

Estimated revenue—Continued.

CALENDAR YEAR, 1922—Continued.

Source of revenue.	Present law.	H. R. 8245.	
		As reported to the House.	As passed House.
Corporation capital stock tax	$80,000,000	$80,000,000	$80,000,000
Stamp taxes:			
Issues and conveyances of stocks, bonds, etc.	55,000,000	55,000,000	55,000,000
Capital stock transfers	9,000,000	9,000,000	9,000,000
Sale of produce upon exchanges	7,600,000	7,000,000	7,600,000
Miscellaneous taxes	11,200,000	11,200,000	11,200,000
Total miscellaneous internal revenue	1,340,000,000	1,025,920,000	980,490,000
Total internal revenue	3,390,000,000	2,622,170,000	2,960,490,000

CALENDAR YEAR 1923.

Income tax:			
Individual	$900,000,000	$750,000,000	$750,000,000
Corporation	415,000,000	560,000,000	560,000,000
Profits tax	450,000,000		
Back taxes (income and profits)	340,000,000	340,000,000	340,000,000
Miscellaneous internal revenue	1,345,000,000	1,030,320,000	994,370,000
Total	3,450,000,000	2,680,320,000	2,644,370,000
MISCELLANEOUS INTERNAL REVENUE.			
Estate tax	150,000,000	150,000,000	150,000,000
Transportation	260,000,000		
Telegraph and telephone	29,000,000	29,000,000	29,000,000
Insurance	20,000,000	13,000,000	
Alcoholic spirits	75,000,000	75,000,000	75,000,000
Nonalcoholic beverages:			
Cereal beverages	19,000,000	12,000,000	18,000,000
Carbonic acid gas		2,000,000	2,000,000
License tax on dealers		10,000,000	
Soft drinks, fruit juices, sirups, etc.	41,000,000	12,000,000	12,000,000
Tobacco	256,000,000	256,000,000	256,000,000
Admission and dues	100,000,000	100,000,000	100,000,000
Section 900:			
(1), (2), (3) Automobiles, trucks, etc.	115,000,000	116,000,000	116,000,000
(4) Musical instruments	12,000,000	12,000,000	12,000,000
(5) Sporting goods	4,000,000	2,000,000	1,000,000
(6) Chewing gum	1,400,000	1,400,000	1,400,000
(7) Cameras	900,000	900,000	
(8) Photographic films, and secs. 901 and 906	6,000,000	6,000,000	6,000,000
(9) Candy	23,000,000	13,000,000	13,000,000
(10), (11), and (12) Firearms, knives, etc.	4,000,000	4,000,000	4,000,000
(13) Electric fans	300,000		
(14), (15), (16), (17), (18) Thermos bottles, cigar and cigarette holders, pipe, automatic slot vending machines, livery boots and liveries, hunting and riding garments, etc	800,000	800,000	800,000
(19) Fur articles	9,000,000	4,500,000	4,500,000
(20) Yachts and motor boats	550,000	550,000	350,000
(21) Toilet soaps, etc.	2,300,000	2,300,000	
Section 902, art works	1,200,000	1,200,000	650,000
Section 904, luxuries	21,000,000	5,000,000	5,000,000
Section 905, jewelry, etc.	25,000,000	25,000,000	25,000,000
Section 907, perfumery, cosmetics, and proprietary medicines	6,000,000	14,000,000	
Corporation capital stock	81,000,000	81,000,000	81,000,000
Stamp taxes:			
Issues and conveyances of stocks, bonds, etc.	55,000,000	55,000,000	55,000,000
Transfer of capital stock	9,000,000	9,000,000	9,000,000
Sale of produce on exchanges	8,000,000	8,000,000	8,000,000
Miscellaneous taxes	9,550,000	9,670,000	9,670,000

Senator SIMMONS. Under the present law it would be $3,450,000,000?

The CHAIRMAN. We want to know what this amendment will do?

Dr. ADAMS. Mr. McCoy estimates that the excess-profits tax for 1922 will yield $450,000,000. He also estimates that 5 per cent additional corporation tax will yield $206,500,000.

The CHAIRMAN. We do not want to go into all that now.

Senator SIMMONS. Mr. McCoy, what is the excess-profits tax for 1921?

Mr. McCOY. The largest excess-profits tax—that was the first year, under the 1918 bill, for the calendar year 1918—was $2,505,000,000. The next year it fell to about one-half of that, and for 1920 it was about $1,000,000,000, in round numbers.

Senator CALDER. How much this year?

Mr. McCOY. $450,000,000 for the year we are in now.

Senator CALDER. How much was collected this year on profits of last year?

Mr. McCOY. It will be about $1,000,000,000 in the calendar year 1921 for the calendar year 1920.

Senator SIMMONS. For the calendar year 1921, you estimate that it will be $450,000,000?

Mr. McCOY. Yes, sir; collected in 1922.

The CHAIRMAN. I still do not see why the House, after thinking for weeks over the matter, suddenly changed front. There must be some reason.

Senator LA FOLLETTE. Did not this come in as a consideration, that they took the people's word that the gentlemen who had been favoring the repeal of the excess-profits tax had been insisting that it was passed along and the gentlemen in the House concluded that it had already been assessed against the people by increasing prices and had been paid by the people, and it would be a clear gift?

The CHAIRMAN. Now, you are getting down to business.

Dr. ADAMS. I believe that was the controlling argument.

Senator WATSON. The speeches made in the House clearly set that forth.

The CHAIRMAN. I have not yet had an opportunity to read those speeches.

Senator MCLEAN. The argument was that large capital will escape the excess-profits tax, and the tax will fall on the smaller corporations, as I understand it.

The CHAIRMAN. Dr. Adams says it will fall on the small ones.

Dr. ADAMS. The heavily capitalized corporations are getting out of the excess-profits tax. There are exceptions, just as you can always find in reference to anything; but, in the main, the corporations that sell their stock on the stock exchange have gone through frequent reorganizations, have a higher or larger invested capital. Even where they have not watered their capital they have utilized every bit of their intangible capital.

Senator MCCUMBER. Your idea is that the small corporation is going to pay the excess-profits tax, and the big corporations are going to escape it, because they will not earn enough on their capital invested, or supposed to be invested, to pay any excess-profits tax?

Dr. ADAMS. That is it. The big corporations, with exceptions—and those exceptions may not be very important—do not earn anything like so high a rate of profits as smaller and more moderately capitalized corporations.

Senator LA FOLLETTE. That is, you believe that the big corporations, in the main, are overcapitalized, and they can not make earnings on their capital? Would the enormous sales they have made and the vast amounts they have expended for advertising—of course, the larger corporations do a great deal of advertising—would that also be an element?

The CHAIRMAN. That is counted in in these patent rights.

Dr. ADAMS. The important thing is this, Senator: These corporations whose stock is on the market have usually been through three or four reorganizations. Every time they do it, they gather up more of the intangibles. Every prosperous corporation has some intangible capital. If it is a close corporation, they have no object in increasing the capitalization. If they are selling their stock, they are likely to get the capitalization as high as they can. The consequence is that for that and for other reasons, if you analyze corporations by the size of their capital, there is a regular connection between the size and the rate of profits. The smaller the size the higher the rate of profits, and the larger the size the lower the rate of profits.

Senator LA FOLLETTE. For many reasons?

Dr. ADAMS. Yes, sir.

(Informal discussion took place, at the conclusion of which the following proceedings occurred:)

The CHAIRMAN. Unless otherwise ordered the committee will meet from 10.30 until 1.30 for the next two or three days, and will not meet on Labor Day.

Dr. ADAMS. To go back to page 9 of this draft, this is probably the most important single section in this bill.

The CHAIRMAN. Those who were very active in the last bill know that pretty nearly every one of these paragraphs is a bloody battle ground. We fought every inch of it.

Dr. ADAMS. This one will be particularly——

Senator LA FOLLETTE. Gory?

Dr. ADAMS. I do not know whether it will be gory or not.

Subdivision (a) of the old law, lines 2 to 10, laid down the simple rule that for purposes of determining gain or loss in the case of property acquired before March 1, 1913, the basis should be its fair market value on March 1, 1913. That is the old rule, with which we are all familiar.

We have a very simple and definite rule that has been in force for many years. A case went up to the Supreme Court last year, which may be illustrated this way:

A man acquired property about 1910, some stock worth at the time about 60. It fell very rapidly in value, and on March 1, 1913, it was worth only 20. He sold it in 1916 at 30. It was sold at less than the original cost, but at more than the value on March 1, 1913. The question was whether there was any gain.

The Supreme Court held that there was no gain and no tax; that, in other words, you could not in all cases simply take the March 1, 1913, value as the starting point.

Senator MCCUMBER. Notwithstanding the fact that we declared in law it should be the starting point?

Dr. ADAMS. The Solicitor General of the United States conceded the point in advance, against the advice and request of the Treasury Department. The Supreme Court took his theory and embodied it in their decision, and now we have got a complicated provision to this general effect, that there is no gain except as measured against the original cost and no loss except against original cost. To the extent that the gain may be said to have accrued before March 1, 1913, it is not taxable. To the extent that the loss may be said to have accrued before March 1, 1913, it is not deductible. In the majority of cases the old rule or measure is not changed, but instead of having a simple rule that you start in all cases with the value on March 1, 1913, we must have a complicated rule. You will find that rule stated here.

Senator SMOOT. That is the decision of the Supreme Court? In the case that you refer to he would have a $30,000 loss under the decision of the Supreme Court?

Dr. ADAMS. Under the decision of the Supreme Court we would recognize no gain or loss. The selling price was less than cost and more than the value on March 1, 1913. The Supreme Court's finding was that there had been a loss up to March 1, 1913, and after that time there had been some profit; but that profit being less than the original cost, you would not tax it.

If you read over the new provisions you will see exactly what we are forced to do.

Senator WALSH. Will you state the name of that case for the record?

Dr. ADAMS. It is the case of Goodrich v. Edwards. The decision was handed down March 28, 1921. It was published in the Federal Income Tax Service, at page 557. I may have given those figures inaccurately. They are merely illustrative. They are sufficiently accurate to explain the point.

Senator DILLINGHAM. Are you going to put into the record the point of the case?

Dr. ADAMS. The point of the case is that, as the department understands it, and as I understand it, there is no gain, except as measured by original cost; and that to the extent that the gain accrued before March 1, 1913, it is not to be taxed. The Solicitor General also maintains that a similar doctrine must be applied to losses.

In the case of a property that steadily rose in value from the time of its original purchase up to March 1, 1913, and steadily rose in value up to the time of the sale, there is no difference now from what there was before. You tax simply the gain accrued since March 1, 1913.

Similarly, in the case of a property going down in value steadily from the original acquisition, if it goes down steadily to March 1, 1913, and continues to go down, in effect you do just as you did under the old law; but if it bobs up and down, or down and up, you have a different rule.

It is a very involved subject. The department regrets the necessity of a change in the law, but we feel that it must be changed. The department endeavored to persuade the Solicitor General of the United States not to make this concession.

Senator McCUMBER. Would it not be better to leave the law just as it is, and if anyone wants to show that he had a loss instead of a gain, let him show it? It does seem to me that we ought to start somewhere to fix the value.

Dr. ADAMS. Well, we do that in one sense, in that we have to use the value on March 1, 1913, to decide how much of the gain or loss accrued before the incidence of the income tax. We still use it for that purpose, and in the most important cases we do not get a different result from that which we have reached in the past; but you have two new categories of cases. If you will read this new subdivision (a), on page 10, you will find the idea a little more precisely stated. It is in line 9.

Senator SIMMONS. Take the illustration you gave a while ago of the stock that was worth, at the time it was purchased, sometime before March 1, 1913, 60 cents. In 1913 it was worth only 30 cents, and when sold subsequently to that date it sold for 30 cents. All the loss there was sustained before 1913?

Dr. ADAMS. Yes.

Senator SIMMONS. The profits accrued between 1913 and the sale.

Dr. ADAMS. Under the old law we would have to tax the profits. Under the old rule or practice of the department the man having bought in 1910 at 60, and the stock having fallen to 20 on March 1, 1913, and having sold it in 1916 at 30, we would have taxed a gain of 10. That is what we proposed to do in the Goodrich case. But the court said there was no gain; that gain must be measured with respect to original cost. That is the fundamental doctrine.

Senator SIMMONS. That seems to me to be beating the devil around the stump. There really was a loss of 30 points, and yet you convert that loss by legerdemain into 30 points profit.

Senator McCUMBER. The result of that decision is that you are allowing losses that people made back of 1913—it might be 40 years back—and allowing them to deduct their losses against a profit that was made after 1913. That is the effect of the decision. The property was worth 20 cents on March 1, 1913. He had already had his loss on that property, and he might have had it 10 years before or 20 years before. You can go back to any number of years. There is no starting place. You can not tax against the 1913 valuation, because what he sold it for was less than he paid for it 1 year or 20 years prior to 1913.

Senator McLEAN. You have got to figure profits on cost some time.

Senator McCUMBER. No. I think you can see that we can put profits and losses in the previous years, and say we will consider that as so much property which you owned, whether you bought it at a profit or at a loss.

Suppose that he had a property that he bought for 60 per cent prior to 1913, and on March 1, 1913, it was worth 100 per cent. Then any profit that he makes, if he sells it after 1913, and sells it for 110, he is only charged a tax upon the 10 per cent profit.

Senator SMOOT. That is all.

Senator McCUMBER. But if, under that Supreme Court decision, he would take what he paid prior to that time—it might be as much as 110 per cent—he would pay nothing.

Senator McLEAN. There may be some force to that position, but when you figure losses you have got to consider the costs, it seems to me. I can see that your illustration there might necessitate a different consideration of profits, but, in any event, you may not have made a profit unless you sell for more than what the article cost you.

Senator SMOOT. In the case the Senator cites under this provision he would be charged with a 10 per cent profit and pay his assessment.

Senator McCUMBER. He has made a profit; his loss occurred prior to that time.

Senator SIMMONS. If it works out as Dr. Adams says you have not changed the law at all, because you accept the 1913 value as the starting point. You say it costs $60, and in 1913 it is worth $20. You figure the loss as having occurred between the time of purchase and 1913, but you take its value in 1913 as the starting point to determine whether he should pay a tax or should not pay a tax. Is not that the present law?

Senator SMOOT. Yes; but the court decides otherwise.

Senator McCUMBER. The court decided that there was no profit.

Senator SIMMONS. I understand that under the plan devised by the department that would be the way of determining the question.

Dr. ADAMS. We had a simple rule. We started with March 1, 1913, and we made no inquiries back of that. In this particular case to which I have referred the stock was worth $20 in 1913. It was sold at $30. We tried to levy a tax,

under the existing rule, on $10. But the Supreme Court said that there was no profit.

Senator McCUMBER. Did I understand you to say you had devised another rule?

Dr. ADAMS. The idea now is to follow the Supreme Court's decision.

Senator DILLINGHAM. Just what is that rule?

Dr. ADAMS. Perhaps I had better read an extract from the Goodrich decision. The court said:

"As to the second payment, the Government confesses error in the judgment with respect to this assessment. The stock was sold in the year for which the tax was assessed for $22,253.75 less than its value when it was acquired, but for $120,710.75 more than its value on March 1, 1913, and the tax was assessed on the latter amount.

"The act under which the assessment was made provides that the net income of a taxable person shall include gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, * * * or gains or profits and income derived from any source whatever. (39 Stat., 757; 40 Stat., 300, 307.)

"Section 2 (c) of this same act provides that 'for the purpose of ascertaining the gain derived from a sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived.'

"And the definition of 'income' approved by this court is 'A gain derived from capital, from labor, or from both combined, provided it be understood to include profits gained through sale or conversion of capital assets.' (Eisner *v.* Macomber, 252 U. S., 189, 207.)

"It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor, and we therefore agree with the Solicitor General that since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him.

"Section 2 (c) is applicable only where a gain over the original capital investment has been realized after March 1, 1913, from a sale or other disposition of property."

May I ask you now to skip down a little and read on page 11, beginning with line 14? It should be remembered that the basis—this is the starting point—is cost, with a few exceptions such as property acquired by bequest.

Subdivision (a) says the basis shall be the cost. Then there are certain qualifications:

"(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 shall be the excess of the amount realized therefor over such fair market price or value."

That is in the case of a straight upward rise.

Senator SIMMONS. What are you reading from?

Dr. ADAMS. Page 11, line 18. That refers to the value as of March 1, 1913. That is the present rule for the ordinary case.

Senator SMOOT. In other words, under the conditions you mentioned you conform to the decision of the Supreme Court?

Dr. ADAMS. Yes.

"(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 March 1, 1913, over the amount realized therefor."

In other words, if you buy property at $60 and it goes down to $30 on March 1, 1913, and you sell at $20 the deductible loss is $10.

The change comes in rule 3:

"(3) If the amount realized therefor is more than such basis but not more than the 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 shall be included in and no loss deducted from the gross income."

Senator CURTIS. Why would not it be simpler to leave the law as it is and cover that by a regulation of your department?

Dr. ADAMS. The question of the losses and gains involved in these kinds of transactions is crucial to many taxpayers. It is so important that it should be a part of the law, so you will have no uncertainty.

Senator CURTIS. You feel that it should be legislation instead of regulation?

Dr. ADAMS. Yes.

Senator SMOOT. If it is legislation, every taxpayer can see the law.

Senator CURTIS. I thought that if you made the rules and regulations the cases might be few in number.

Dr. ADAMS. We should have a statutory rule. The old rule was simpler than the one proposed, but in view of the decisions referred to we feel that the proposed rule is the right one, and perhaps the only safe one. We should take no chances with a rule which the courts might upset.

The CHAIRMAN. Has it not been the policy to bring these things within the law, so that they will be fixed and settled?

Dr. ADAMS. Yes.

Senator MCCUMBER. What objection would there be to a provision taking March 1, 1913, as the basis, and letting the gain be represented by any sum in excess of the value of the property as of March 1, 1913, except in cases where the property was purchased prior to March 1, 1913, for a greater sum than the sum for which it was later sold—make it as simple as possible and end it? What is the use of all this complexity?

Dr. ADAMS. We must have a rule for losses and one for cases where there is no loss and no gain, even if we accept the principle on which your proposed rule for gains rests. When that is done the rule or set of rules becomes complicated. The proposed rule takes in only lines 14 to 25, and 1 to 5.

Senator CURTIS. We will have to explain it from time to time to every new Member who comes on the floor of the Senate.

Dr. ADAMS. I much prefer the simpler rule, which was upset by the Solicitor General and the Supreme Court.

If you will consider the other special cases on page 10, you will get a better idea of this. Section 202, subdivision (a), starting line 9, reads:

"The basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property—real, personal or mixed—acquired after February 28, 1913, shall be the cost of such property."

Then there are certain exceptions:

"(1) In the case of such property, which should be included in the inventory, the basis shall be the last inventory value thereof."

That is the present law.

"(2) In the case of such property, acquired by gift, after December 31, 1920, the basis shall be 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. If the facts necessary to determine such basis are unknown to the donee the commissioner shall, if possible, obtain such facts from such donor or last preceding owner or any other person cognizant thereof. If the commissioner finds it impossible to obtain such facts the basis shall be the value of such property as found by the commission, as of the date or approximate date at which, according to the best information the commissioner is able to obtain, such property was acquired by such donor or last preceding owner. In the case of such property acquired by gift on or before December 31, 1920, the basis for ascertaining gain or loss, from a sale or other disposition thereof, shall be the same as that provided by this act before its amendment by the revenue act of 1921."

Perhaps the greatest abuse of the income tax in recent years has been through gifts.

Senator WALSH. Of stocks and bonds?

Dr. ADAMS. Principally.

The CHAIRMAN. It is a legitimate evasion?

Dr. ADAMS As an example, let us say that an individual bought stock in 1914. It cost $50, and perhaps it rose to $80 in 1920. He wants to sell. So he gives it to his wife or to his child. At the present time the donee starts with the value of the gift at the time of its receipt. If the husband sold in this case he would be taxed on a profit of 30 points. But if he gives it to his wife and she sells at $81 they pay tax on a profit of only 1 point. If she sells at 75, she sells at a loss of 5 points.

Senator CURTIS. Hasn't the department done anything to test cases of that kind?

Dr. ADAMS. Yes. If there is anything colorable about them we can handle them. However, where there seems to be a bona fide gift, we are unable to do anything. The practice is said to have been widespread and prevalent. We hear of it from every point.

Senator LA FOLLETTE. But you would have to prove it before you could take any action. A gift from a husband to a wife would be recognized by your department as a bona fide gift, unless you had some strong evidence to the contrary.

Just take the statement that you have made with regard to the stock, and the great advance in its value; how would your department have treated a case of that sort?

Dr. ADAMS. If it were given to the wife we would immediately investigate the instrument by which it was transferred and all the surrounding circumstances. We would determine whether title had passed, whether there was any possibility of the husband getting it back from the wife, and so on.

Senator LA FOLLETTE. But if there is nothing in the instrument itself to disclose a private understanding between the husband and the wife that this was a temporary affair, you would be bound by it, would you not?

Senator CALDER. Does the law require the owner or the donee to make any statement?

Dr. ADAMS. Yes; it can be required.

The result of it has been that there have been hundreds of these colorable gifts. And there have been hundreds of cases where men have made up their minds that they would rather give their property away than pay the tax to the Government.

The CHAIRMAN. That is proper and legitimate.

Dr. ADAMS. I do not think there is any reason at all why the Government should accept as a basis the value as of the time it was given away.

Senator LA FOLLETTE. I would be rather skeptical about that statement.

Dr. ADAMS. Which one, Senator?

Senator LA FOLLETTE. That people give their property away rather than pay this tax to the Government. I suppose there are cases that are apparently gifts, with a string tied to them.

Dr. ADAMS. That may be true.

It seems to me at this time particularly, when losses are being claimed, that it is not fair to claim losses against the later value, but that the loss should be measured against the original cost. We are not asking anybody to pay the tax—we are not asking the donee, the wife or the child—until they actually sell at a profit, but when they do sell, we say they should employ the natural basis for computing the profit.

Senator MCCUMBER. Suppose you give to your child, out of affection for that child, property that cost you 30 points 10 years ago and is now worth 80 points. Suppose you do this with the idea that the child shall have that property and have the income from it. In good faith the child may, a year from now, or two years from now, or at any time when it is thought best, sell that property or convert it into other property. Suppose it sells for 81 points. Why should that child be penalized by having to pay a tax on a profit based upon the value of that property 10 years ago? It has not made a profit. Why should it be compelled to pay a profit if it has not received it?

The CHAIRMAN. One might have to sell property by reason of the cessation of dividends, or something of that kind, where it would be absolutely necessary to sell it.

Senator SMOOT. That happens in the case of my own children. I give each one so much when he or she is married. Most of them have had to sell what I have given them.

Senator MCLEAN. Nevertheless, in the last few years property has been given away for the purpose of evading the tax.

Senator MCCUMBER. If it was a colorable transaction, that is different. If the person who is the donor simply puts the property in some one else's name, with the idea that he shall hold the property temporarily and thus hold back on the tax, of course that is not right.

Senator SMOOT. Do you say that a gift to a child is exempt?

Dr. ADAMS. The gift is exempt from taxation; yes. I do not mean by that that it is deductible. It is not taxable.

Senator SMOOT. That is to the recipient?

Dr. ADAMS. Yes. It is regarded as a capital transaction.

Regarding that aspect, it might be made clearer by contrast with a man who bought his property. For example, John Smith buys a farm. He later sells the farm at a profit, and he pays a tax on the profit. Somebody else has a farm given to him by his father. He starts with a higher valuation, and he pays no tax.

Senator SMOOT. Let me understand you perfectly. In order that I may do that I shall take a personal illustration, so that I shall be sure of the facts. I have a child who is married—in fact, I have five of them. Each child when married gets so much money from me. That, generally, is in the form of stocks

that I have held for years and years. Under this provision, do I understand that if they sell these stocks they have to take them at their value in 1913?

Dr. ADAMS. The value at the time they were acquired by you.

Senator SMOOT. I acquired them in 1913, we will say.

Dr. ADAMS. Yes.

Senator SMOOT. Some stocks, particularly one or two, that I have given to one of my children they could not sell and pay a tax.

Dr. ADAMS. There is no tax on them until they sell them.

Senator SMOOT. If they sold them, they could not pay the tax.

Senator WALSH. Why not?

Senator SMOOT. Because the gain in 1913 had been exceedingly high.

Dr. ADAMS. Suppose you had to sell them?

Senator SMOOT. Then I would take something else. I wanted to know because my future attitude will be based upon the answer to that.

Dr. ADAMS. A great many remedies or changes have been suggested with respect to this gift problem. This one, it seems to me, if you want a change or a remedy, is both moderate and sound.

Senator MCCUMBER. The first thing is to decide whether we want to attach a penalty to the gift. If you sell a thing afterwards that you received, you have got to go back and pay a tax.

Senator SIMMONS. If that stock had remained in Senator Smoot's hands, he would have had to pay a tax.

Senator SMOOT. There is no doubt about that.

Senator SIMMONS. Then, why should the donee or the beneficiary of your kindness escape paying any tax at all?

Senator LA FOLLETTE. They invested nothing.

Senator SMOOT. I ought to pay the tax.

Senator SIMMONS. If the child sells the stock the tax does not have to be paid at all.

The CHAIRMAN. Suppose that this had been an industrial and that Senator Smoot had been getting a large income and that within the last two or three years this ceased, and the child, having no income, had to sell the stock in order to provide an income to live.

Senator SMOOT. I have one, and he has not only spent all that, but more, too.

Suppose they went and borrowed 60 per cent of the value of the stock, and they were forced to sell. They would not get a dollar.

Senator SIMMONS. It would be the same as if you had to sell it.

Dr. ADAMS. It would depend upon the size of the income.

Senator SIMMONS. In other words, the Government ought not to lose this tax because there was a gift.

Dr. ADAMS. You must remember that the situation is likely to be different in the future. In the case of many donors in the past—fathers and husbands—they purchased the stock when it was cheap. It has gone up. They gave it away when it was high. In the future that situation is likely to be reversed. Persons have purchased stocks at high prices, and will give them away at lower levels. In that case the donee is entitled to claim a larger loss when he sells. It works both ways.

Senator SIMMONS. Suppose that I buy stock and it goes up. I can give that to one of my daughters and let her sell it instead of me and thus avoid the tax.

Senator SMOOT. But that would be fraud there.

Senator WALSH. But that is what is happening.

Senator SMOOT. That is true; that is what is happening, but we are now speaking of cases where there is no fraud.

Senator WALSH. Legitimate cases?

Senator SMOOT. Yes.

Senator WALSH. I should think that a sale that takes place soon after the gift would presuppose fraud.

Senator MCCUMBER. We had a case before the committee a short time ago. It was that of Mr. Cannon, as I remember it. In that case the department held that the gift was not made in good faith, and the department was sustained. I do not think we need to say that we are going to penalize every gift.

Senator LA FOLLETTE. I think we understand this, do we not? Why not move on?

Dr. ADAMS. Line 8, page 11:

"(3) In the case of such property acquired by bequest, devise, or inheritance the basis shall be the fair market price or value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acqui-

sition of such property interests as are specified in subdivisions (c) or (e) of section 402."

That is where property is transferred in contemplation of death.

Senator McCUMBER. Whatever the child receives by inheritance or bequest it gets without cost or sale exactly the same as a gift. In the next paragraph you make a distinction.

Dr. ADAMS. That is because the estate or inheritance tax has been imposed. That is the thought behind that.

Senator McCUMBER. You take the value as of that date; that is the point.

Dr. ADAMS. Yes: the date of acquisition. Now we come to subdivision (b):

"(b) The basis for ascertaining the gains derived or losses sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a)."

That is what I read before.

The CHAIRMAN. Are all these provisions rulings of the department?

Dr. ADAMS. Not all. The provision as to the basis for gifts is not a ruling of the department. That is new. Subdivision (b) gives, as we understand it, the rule laid down by the Supreme Court and is new.

Having taken up the other provisions we now skip to subdivision (c) on page 12:

"(c) In ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, proper adjustment shall be made for (1) any expenditure properly chargeable to capital account, and (2) any item of loss, impairment, exhaustion, wear and tear, obsolescence, amortization, depletion, depreciation, or similar expense properly chargeable with respect to such property."

The rules in subdivisions (a) and (b) are only bases from which to start. You have got to make adjustments for betterments and additions. To illustrate, we will say that in the case of property acquired after March 1, 1913, its basis shall be the cost. You may sell that property in 1920. In the meantime you may have put up a factory. You may have taken deduction for depreciation upon it. These things all have to be taken into account to modify the original cost basis.

The CHAIRMAN. As to those words used there, are they any different from the phraseology that was used in previous bills?

Dr. ADAMS. They are not used in previous bills.

The CHAIRMAN. Well, obsolescence is not new.

Dr. ADAMS. No. Those are the words used in authorizing corresponding deductions.

The CHAIRMAN. In other words, it is the same language practically.

Dr. ADAMS. Yes; the same language practically. Now comes subdivision (d):

"(d) For the purposes of this title, on an exchange of properties, real, personal, or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value; but, even if the property received in exchange has a definite and readily realizable market value, no gain or loss shall be recognizable."

The present rule you will find, if you want to read it, on page 9, lines 11 to 21, is as follows:

"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; but when, in connection with the reorganization, merger, or consolidation of a corporation, a person receives in the place of stock or securities owned by him stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged."

With reference to lines 11 to 14, that means that in the exchange of property for property—trades, as they are frequently referred to—we have recognized a loss or gain. Whenever the property received in exchange had a market value, loss or gain were recognized. If a man trades a farm for a farm, that gives rise to a taxable gain if the farm received is worth, at the time it is received, more than the cost of the farm given in exchange.

Now, that rule is changed and, as the proposed rule now reads, on the exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market

value. I should say that perhaps in a majority of cases of such exchanges the value of the property received is not definite.

The CHAIRMAN. Don't you think that that paragraph would open the door wide to all kinds of abuse?

Dr. ADAMS. I do not think so, Senator.

The CHAIRMAN. I have in mind one of the largest concerns of its kind in the country that has no market value, because it is largely in the hands of the employer and employees. He could make his stock worth 40 or 140 to-morrow morning, if he saw fit. All I know is that this is one of the biggest concerns in the country. I have no commission to speak for them.

Senator WATSON. In the case you mention, Senator Penrose, would the stock have a definite and readily realizable market value?

The CHAIRMAN. I do not think so.

Senator SMOOT. One of the inconsistencies would be this, that the property exchanged would be worth to the man that wanted it twice as much as it would be to the man that exchanged it. It is difficult to know at this juncture what is the definite and readily realizable market value. Nothing is definite now.

Dr. ADAMS. The object has been to change the rule which presumed taxability in every instance—to change that presumption to one of nontaxability. This proposition cuts both ways. It eliminates losses and gains; and it is further to be remembered, of course, that the man who takes this property receives it on exactly the same basis as the old property.

If I trade a farm costing $10,000 for a farm worth $16,000, I would treat the $16,000 farm on a $10,000 basis for purposes of computing gain on subsequent sale, depreciation, etc.

As to the specific cases where there is to be no gain or loss, you will find them beginning with line 20, page 12:

"(1) When any such property held for investment or for productive use in trade or business (not including stock in trade or other property held primarily for sale) is exchanged for property of a like kind or use."

Senator WATSON. Give us an illustration.

Dr. ADAMS. An illustration would be where stocks were exchanged—stocks for stocks or bonds for bonds—or where a factory was exchanged for another factory.

Senator DILLINGHAM. What do you do with cases where, to use a common expression, "boot" is paid?

Dr. ADAMS. At the present time we tax most such transactions. In the proposed new law an amendment dealing specifically with such cases should be introduced.

Senator SMOOT. It does not say that they shall be of equal value. It simply says "property of a like kind or use." According to that the value of one bond might be $50 and that of another $150.

Dr. ADAMS. This provision would exempt the gain temporarily until the property was sold, not "exchanged."

Senator SMOOT. Or stocks?

Dr. ADAMS. Stocks or bonds would be held for investment.

Senator SMOOT. They are all held for that.

Dr. ADAMS. Suppose it was a merchant selling in the trade.

Senator SMOOT. Suppose that my wife had a bond that is worth $50 and suppose that I had an identical bond worth $150, and suppose that we exchanged.

Dr. ADAMS. There would be no gain or loss if the bonds were held for investment or were not of a definite and readily realizable market value.

Senator SMOOT. Then suppose that it was outside of the family.

Dr. ADAMS. It would be the same, with the additional features as to whether the exchange was made in connection with the reorganization of a corporation.

Senator MCLEAN. Nobody outside the family would exchange a $150 bond for a $50 bond.

Senator SMOOT. It would be a transfer of bonds. It may be that when sold again he would have it based upon the value of the bonds that he received and not on what he transferred.

Dr. ADAMS. You will recall that we are dealing with exchanges of property for property.

The next provision reads:

"(2) When in the organization or the reorganization of one or more corporations a person receives in place of any such property owned by him new stock or securities. The word 'reorganization' as used in this paragraph in-

cludes a merger, consolidation (however effected), recapitalization, or a mere change in identity, form, or place of organization of a corporation."

That is perhaps the most important provision in the proposed law. Under existing law in case of reorganization if the stockholder receives new stock or securities of like par value no tax is imposed. If, however, the par value of the new securities exceeds the par value of the old stock or securities under existing law a tax may be imposed. It is proposed to change that and to say without qualification that if in the course of reorganization, merger, consolidation, recapitalization, and so on a man surrenders old stock and takes new stock there shall not be any tax. Of course, he will take the new stock on exactly the same basis that applied to the original, but this will not be the time for the recognition of gain or loss.

Senator McCUMBER. Suppose you have a corporation that has, we will say, a $100,000 capitalization, the capital stock being worth 100 per cent. It then reorganizes and issues $200,000 of capital stock, of new stock, and the $200,000 of stock has a salable value of 75 per cent. The person who receives the extra amount has made 35 per cent upon that, has he not, if it will actually sell for that?

Dr. ADAMS. Fifty per cent, has he not?

Senator SMOOT. If there were such a case.

Senator McCUMBER. Yes. The very fact that certain stock reads $100 on its face gives it a certain value. In other words, its value does not go down 50 per cent if you issue twice as much. In the market you will find it will sell for more than what the original stock was worth. It seldom goes down to the original price. Most of them reorganize on the assumption that their business will be bigger, and that they may have to use more capital, and so forth, and it gives a value in excess of the value of the stock which was surrendered. If the actual cash value were greater than the original value, would you say that there should be no tax levied?

Dr. ADAMS. Under the present law a tax is imposed, provided the par is higher.

Senator McCUMBER. I am asking why that is so.

Dr. ADAMS. The change is recommended because, in the first place, it is difficult to make appraisals. In the average reorganization, or in many reorganizations, there is no definite, fixed market price for the securities. That is one reason. In the second place, it is possible to avoid the tax by the use of no par-value stock. In the third place—and this is the most important reason—where any heavy tax is involved the reorganization is held up. They do not do it. All kinds of business readjustments have been stopped. Finally this process is now being indulged in to register losses. When they could make heavy gains, which would subject them to a heavy tax, the transaction is blocked. On the other hand, where losses are to be registered, there is an additional incentive to make the reorganization. But the principal defect of the present law is in blocking desirable business readjustments.

For instance, under the present law, if a corporation reorganizes with an increase of capitalization, a tax may be imposed, although the provisions of the present law in this connection were designed to tax what may be called "indirect stock dividends," and the stock dividend may now be distributed tax free. The stockholders say we are getting no new or additional tax—why tax us now? The reorganization itself may be a good, legitimate, and desirable thing. Why tax it at that time?

Senator SIMMONS. There has not been any increase in property; there has not been any sale of property; the owner of the property has just simply agreed with the co-owner that they will change the basis of capitalization. I do not see that anything has transpired that entitles the Government to a tax.

Dr. ADAMS. The next provision, number three, deals with a series of cases:

"(3) When (*a*) a person transfers any such property to a corporation, and immediately after the transfer is in control of such corporation, or (*b*) a group of persons transfers any such property to a corporation, and immediately after the transfer is in control of such corporation; and when the amounts of stocks, securities, or both, received by such persons are in substantially the same proportion as their interest in the property before such transfer. For the purposes of this paragraph a person or group of persons is 'in control' of a corporation when owning at least 80 per cent of the voting stock, and 80 per cent of all other classes of the stock of the corporation."

At the present time, if an individual owns a mine or a farm and wants to incorporate and take practically 100 per cent of the stock, theoretically he has

converted real property into personal property. I do not know what the courts will do with that when it goes to them.

If one man incorporates his property or if a group of men incorporate their property, that mere formality, in one sense, of placing the property in corporate ownership subjects them to a tax, provided the stock received has a market value in excess of the cost of the property to the individual.

Take a case as an illustration: Suppose a man buys land. It costs him, we will say, for a piece of suburban property $500 per acre. He holds that property for five years until it is worth $1,000 an acre. Suppose, then, he wants to incorporate. He turns it into the corporation and takes all the stock. That stock would be the equivalent of $1,000 an acre. He has made a profit of $500 an acre and is taxed under the present law. It is that sort of transaction, and the possibility of abuse in taking losses, in the reverse case, that seems to me to make something of this kind highly desirable. I can not believe that there is enough difference in the ownership of the property and the stock under such circumstances to justify us in recognizing taxable gain or deductible loss.

Senator SMOOT. The property owner does not own one cent more than when the transaction was made.

Senator SIMMONS. Imposing taxes on things of that sort is what the Secretary, as I remember, characterized as a clog upon enterprise. There is no justification for a tax of that sort. It is one of the forms of business. There really has been no profit made. It is just a change in the kind and character of title to the property; that is all.

Dr. ADAMS. The next is section (e):

"(e) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (d), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor."

The CHAIRMAN. That is simply a statement of fact.

Dr. ADAMS. That is very important. For instance, reverting to the case of real estate about which I spoke, it cost $500 per acre. When the man gets stock for it he has to keep that stock on a $500 basis, so that if he subsequently sells it, he shall take a gain or loss on a proper basis.

The next is (f):

"(f) The basis for ascertaining allowable deductions for loss, exhaustion, wear and tear, obsolescence, amortization, and other like deductions except those authorized in paragraph (10) of subdivision (a) of section 214, and in paragraph (9) of subdivision (a) of section 234, shall be the same basis as that provided by subdivisions (a) and (b) of this section."

That is for the purpose of computing depreciation, the basis shall be the same as provided for gain or loss. The exceptions that are made have reference to the depletion deductions.

The deductions for depletion on property acquired before March 1, 1913, are based on the value as of March 1, 1913, in lieu of cost. Because it has been so difficult to establish those values and because of the importance of the principles involved, it has been thought desirable to let the present rule stand. The depletion for mines, oils wells, and timberlands may be based upon the value as of March 1, 1913. That is the exception. That is so in the present law.

The CHAIRMAN. We seem to have reached a good place to take a recess.

(Thereupon, at 1.30 o'clock p. m. a recess was taken until 10.30 o'clock a. m. to-morrow, Friday, September 2, 1921.)

INTERNAL REVENUE.

FRIDAY, SEPTEMBER 2, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder Simmons, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. At the time of adjournment yesterday afternoon we had reached page 14, I think it was.

Dr. ADAMS. Pages 14 and 15 have to do with a provision reviving in modified form the old net-loss allowance. There was in the revenue act of 1918 a provision that if a business concern sustained a net loss in any year that it should be permitted to charge that loss against profits of the preceding year, or, if the preceding year showed no profits, against the profits of the succeeding year.

Senator MCCUMBER. That is now the law, is it not?

Dr. ADAMS. It was limited in application. It was not applicable to any taxable year beginning after December 31, 1919.

The Treasury Department has suggested to the House, and the House has accepted the proposal, that that be revived, but in a modified form. It is made prospective only; that is to say, the net losses may be recognized only after December 31, 1920, and they are carried forward only and not backward. The net loss that is first recognized is the loss of this present year. If a business concern has a loss in this year, 1921, it may subtract that from profits of 1922.

Senator SMOOT. That is the way you have it now?

Dr. ADAMS. That is the way it is in the House bill. If it can not be absorbed from the profits of 1922, they can take it from the profits of 1923. There is a three-year spread; but the law is changed so that it goes forward instead of backward.

The CHAIRMAN. What is the idea in restricting it to 1921?

Dr. ADAMS. The losses in the year 1920 were very heavy. We do not know what the effect of allowing 1920 losses on the Treasury would be. If the Treasury were in position to permit absorption of these losses, I think it would be a good thing to do, but it is probably impracticable.

The CHAIRMAN. If it is humane and equitable for one year, it seems to me it ought to be humane and equitable for another year.

Dr. ADAMS. I think that ordinarily that is a sound conclusion. The Treasury Department recommended in 1918 that it be made permanent. Congress confined it to one year only. The finances of the Government and the tax rates were adjusted accordingly, and it is now too late to make provision for refunds.

The CHAIRMAN. Just one moment, Dr. Adams.

Senator Calder, a matter has come up this morning in which you are very much concerned. It relates to the appointment of a subcommittee and has reference to a certain form of taxation. Some gentlemen have appeared who want a subcommittee formed. Your attention, I think, has been called to it. I have a letter this morning, and I am inclined to think that there will be a great deal

of pressure brought to bear on this. I was going to suggest the formation of a subcommittee with you as chairman to hear these gentlemen. If you will suggest first whom you wish associated with you, I shall be glad to appoint them.

(Informal discussion followed, at the conclusion of which the following ensued:)

Senator WALSH. I move for the sake of having a record, that all requests for hearing and for presentation of arguments be presented in writing, and that the parties making such requests be informed by the secretary of the committee that copies of arguments or petitions should be sent to each member of the committee.

Senator SIMMONS. And printed for the use of the Senate?

Senator WALSH. Yes.

The CHAIRMAN. Is there any objection to the motion put by Senator Walsh? If not, it is the sense of the committee, and the clerk will make an entry of the motion in the minutes.

Dr. ADAMS. We were discussing net losses. The details of the proposal are as follows:

"Section 204. (a). That, as used in this section, the term 'net loss' means only net losses resulting after December 31, 1920, from the operation of any business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such business); and when so resulting means the excess of the deductions allowed by section 214 or 234 of this act, as the case may be, over the sum of the following: (1) The gross income of the taxpayer for the taxable year, (2) any interest received free from taxation under this title, (3) the amount of deductible losses not sustained in such business, (4) amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil, or gas well as is based upon the discovery value in lieu of cost."

In other words, the net loss that is going to be carried forward is the excess over the gross income, but if he has received tax-free income, or if the loss is not sustained in the business, or if it is a corporation and it receives dividends, there will be no recognition of it; that is to say, a net loss based on those things is not recognized for this purpose.

Then, lastly, depletion deduction, if based on discovery value rather than on cost, is not recognized.

Senator CURTIS. What effect does this provision have upon companies that made exceedingly large profits during the war, but have not declared dividends and are now operating at a loss?

Dr. ADAMS. I do not know that it would have any effect on those companies. I do not know whether or not you recall that the depletion allowance for depletion of mines and oil wells is, in case of discovery, based not on the cost or money invested, but upon the value of the mine or oil well within 30 days of the discovery; that is to say, a company may invest $15,000 in sinking a well, and may bring in a well which is valued at that time at $600,000 or $700,000. No change is made in the right to take depletion for any particular year on the basis of the discovery value. That remains as it has been. But the House decided that that particular kind of loss is not one that is so real that is should be carried forward from year to year.

Senator CURTIS. You did not answer the question that I asked. The question I asked was what happens to those companies that made large profits during the war, but instead of declaring dividends let them go over as surplus or undivided profits, and now find themselves running at a loss; would they be entitled to deductions?

Dr. ADAMS. Yes. This is limited, however. We would not recognize any loss under this until 1921, and the first tax to be affected would be that for 1922, payable in 1923.

Senator SMOOT. God help the Treasury for 1922! If you were to put this back to this year you would not have any.

Senator MCCUMBER. Let me see if I understand this amended proposition. In the case of a loss accruing from the sale or disposition of any kind of security, the interest upon which is not subject to taxation, they can not deduct that from their general loss; is that it?

Dr. ADAMS. That is in the case of the investors. No investor can avail himself of this section.

Senator McCUMBER. In other words, if a person buys State warrants or county warrants and they should prove invalid, and he lost them all, because the interest is not subject to taxation he could not set off that loss?

Dr. ADAMS. He would be ruled out unless the loss was in his business. If you buy and sell securities at a loss, that loss is recognized under this section, provided you are engaged in the business of buying and selling securities. This is confined to business losses.

Senator WALSH. The individual who bought the security and lost could not charge that off in his accounts?

Dr. ADAMS. He could not carry it forward. He has still the right to charge it off in any particular year. This is a question of spreading it over subsequent years. I feel that failure to do this is really a fundamental defect in income tax procedure. Some businesses are more hazardous than others, as we all know. In one year a business will make a great deal of money and the next year meet with a loss. Under such conditions that business is in a rather unfair position, compared with a business that is regular and safe in its operation.

The English, I may say, have had a three-year average proposition, which does much the same as this does, although it has imperfections which this avoids. While I doubt very much if the Treasury Department could stand for a provision recognizing losses of 1920, if you can put it off for several years, I think it highly desirable that it should be done.

Senator GERRY. When does it begin?

Dr. ADAMS. Not until the year we are now in, and the losses will not be counted until 1922. It would be the tax for 1922, but the tax would not be payable until 1923, so that the Treasury Department would not feel it until 1923.

Senator SMOOT. You will feel it on the first payments in 1922.

Dr. ADAMS. No; I think not. The first loss is for the year 1921. That would be deducted from the income of 1922. The payments of the taxes for 1922 are not made until 1923.

Senator SMOOT. The payment is made on March 15, 1922.

Dr. ADAMS. No; 1923.

Senator SMOOT. It is the business of 1921. The returns are made out by March 15, 1922. This applies to the business of 1921.

Dr. ADAMS. But, Senator Smoot, the losses of 1921 would not reduce the taxes. You would not get the taxes

Senator SMOOT. That is just the point I am getting at. They would have to pay during that year. If they have made a gain in 1921, they would have to pay; if they incurred a loss that amounted to more than the tax amounted to, in 1923 the Treasury would begin to feel that loss.

Dr. ADAMS. Yes; in 1923 they they would begin to feel it.

Senator WATSON. Do you favor this section, Dr. Adams?

Dr. ADAMS. I favor it very much.

Senator SMOOT. We will have to begin to think of raising taxes from other sources.

Senator McLEAN. If the loss is more than the income, it is carried on for another year?

Dr. ADAMS. Yes. It is carried against the succeeding year.

Senator McLEAN. Do they keep on?

Dr. ADAMS. For three years. After three years the loss is dead.

Senator SIMMONS. I think that is a discrimination. The losses that have been sustained were sustained last year. You are not going to allow them to carry forward the loss. There is another class that is going to sustain a heavy loss this year. You permit them to carry their losses on and spread them over a number of years to come.

Senator McCUMBER. What classes are you speaking of?

Senator SIMMONS. I am speaking of the farmer.

Senator McCUMBER. The farmer has not paid any taxes, either.

Senator SIMMONS. Many of them have paid taxes. They have sustained losses and still paid taxes.

Senator McCUMBER. Is not farming a business?

Senator SIMMONS. Yes; but what I am discussing is this: This section, as I understand it, enables the business that sustains losses in this calendar year to carry those losses over and offset them against the income of the next calendar year. I say that the farming element sustained their losses and got

down to rock bottom last year. They will not be permitted to carry their losses to this year?

Senator McCUMBER. Why not?

Senator SIMMONS. Because this provision begins with this calendar year.

Senator SMOOT. This is the year that they have lost heavily.

Senator McCUMBER. It puts them on the same basis as the others.

Senator SMOOT. So far as this particular provision is concerned every mining institution in the State of Utah will find itself in the position of not having to pay taxes in 1923.

Senator SIMMONS. I am speaking with reference to the farming situation in my part of the country. I am not familiar with yours.

Senator McCUMBER. Your objection is that it does not include 1920 losses?

Senator SIMMONS. Yes. Their losses were sustained in 1919–20—the calendar year 1920. They got down to rock bottom; they can not sustain further losses. They can not carry those losses over to this year at all. This is the year that the other businesses of the country are going to suffer their losses.

Senator SMOOT. Haven't the farmers sustained greater losses this year than last year? Our farmers have sustained more loss this year than last year.

Senator SIMMONS. That may be so, but ours were sustained this last year.

Senator DILLINGHAM. Isn't it the fact that many other classes met losses just as the farmers did?

Senator SIMMONS. I think that is true, but not to the extent that the farmers did. The point I am trying to make is that their losses came first.

Dr. ADAMS. Some industries came before farming.

Senator SMOOT. I should say they did. They have not recovered.

Senator SIMMONS. If this had begun last calendar year instead of this calendar year that point would be disposed of.

Senator McCUMBER. Before January 1, 1921, we had petitions from all over the country asking us to allow them to deduct the 1920 losses from the previous year's gains, and we refused that request upon the ground that the Government absolutely needed the money. We declined to allow them to deduct their losses as they requested.

Senator SIMMONS. I am inclined to think that, as a matter of policy, that is sound. However, if you allow them to spread the losses over subsequent years I think you will wipe out the tax. I think that it is extremely dangerous to begin to do it now.

I do not think anybody can estimate how much that provision will yield the Government in income taxes for the next year.

Senator SMOOT. Take the Utah Copper Co.; under this provision I doubt if they will pay anything until 1925.

Take the Utah Sugar Co. They lost over $7,000,000 during the last year and this year. That is only one company in my State. It will take five years to make that back, and they will have to be good years at that.

Senator SIMMONS. Considering my losses and spreading them over subsequent years, it will take me four years to absorb my losses of last year. There are many people whose losses this year it will take four years to absorb.

Senator WATSON. Didn't some one of the steel men testify that the Steel Corporation is losing about $200,000 a month now? What effect would this have?

Dr. ADAMS. Those losses would be recognized, but would not reduce the Government's revenue until the calendar year 1923.

Senator SMOOT. And in 1923 we pay the bonus!

Dr. ADAMS. The Treasury Department has considered this very carefully. It would have liked to authorize deductions for net losses of 1920. That, however, seems impracticable. The department thinks the House provision is safe. They think this will relieve the taxpayers eventually, and that by 1923 we shall be able to stand it. The department thinks that prosperity will have returned by that time and that we can then stand the strain; that, in any event, if these corporations have these losses, it is not fair to tax them heavily in their prosperous years and then take no account of those years in which they are in red ink.

In my opinion, it would be better to raise the rates than to deny this provision and lower the rates.

Senator SMOOT. If we keep this provision in, I want it understood that I will be compelled to vote for any kind of additional tax to make it up. I want to say to you that we can not raise sufficient money to pay the obligations of the Government under this bill

Senator WALSH. What is the difference between allowing this to be done by corporations and not by individuals?

Dr. ADAMS. This relates to individuals.

Senator WALSH. I thought you said it was confined to business and not to individuals.

Dr. ADAMS. It is confined to business, but we have more individuals in business than corporations.

I think it would be wise if you made this read "trade or business."

The CHAIRMAN. What is that, Dr. Adams?

Dr. ADAMS. I say I think this ought to be extended to include "trade or business" and not confined to business merely.

Senator MCCUMBER. Make it "trade, profession, or business."

Senator SIMMONS. You want it broad enough to cover everybody and everything.

Dr. ADAMS. I do not think a loss which comes about through the burning of an automobile or the destruction of household goods ought to be taken into account. I do not believe personally that it ought to be extended to ordinary losses of jewelry and that kind of thing. They can not be checked. The country would be thoroughly satisfied if you confined it to trade, business, or profession.

The CHAIRMAN. Where is the list of the losses—in the regulations of the Treasury Department?

Dr. ADAMS. No, sir; in section 214. I do not believe the logic of the situation includes that character of loss. I do not believe it should be extended there.

Senator MCCUMBER. "Losses in business?"

Dr. ADAMS. Yes.

Senator MCCUMBER. It does not mean an automobile; that is not part of the business.

Senator SMOOT. But suppose the business uses an automobile?

Senator MCCUMBER. Then that is a part of the business?

Dr. ADAMS. Yes.

We come now to page 16, line 11, where the method is set forth:

"(b) If for any taxable year beginning after December 31, 1920, it appears, upon the production 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, the deductions in all cases to be made under regulations prescribed by the commissioner, with the approval of the Secretary."

Senator WALSH. (b) and (c) are substitutes for the old provisions?

Dr. ADAMS. And they are practically the same thing.

Senator MCCUMBER. Judging from that, you can deduct any kind of loss.

Dr. ADAMS. The words "net loss" are defined in "(a)" as "net losses resulting from the operation of any business." They are confined to business.

"(c) In ascertaining whether a net loss (as defined in this section) has resulted in any taxable year, the computation shall be made without reference to the provisions of section 207;"

That is a section that is quite new, and it refers to capital losses and capital gains.

"And if a net loss is established, it shall, in the first or second succeeding taxable year or years, be taken into account for the purposes of section 207 as a deduction in computing the ordinary net income as defined in such section."

That section makes a distinction and a difference between the ordinary income and the capital income, and provides that a limit shall be placed upon the second class of income. In order that this net loss that is carried forward in business from year to year may be properly defined as going into one of those two classes it is stated that the net loss continued from one year to another shall be treated as ordinary loss or gain, and not as capital loss or gain.

"(d) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust under regulations prescribed by the commissioner with the approval of the Secretary."

That is the old law.

Coming now to section 205, I am very much in doubt whether there is anything to be gained by reading it. This relates to the complicated situation

in which a taxpayer has a fiscal year overlapping the calendar year. That causes difficulty when the rates are changed.

We have had a method by which, in case the rates are changed, the taxpayer computes his income for 12 months on the basis of the earlier rate and then prorates for the number of months in the first calendar year. Secondly, he computes the taxes under the later rate, and again prorates for the number of months in the second calendar year.

It is a terribly complicated affair if you try to read it. Is it necessary?

Senator SIMMONS. Is that all of 205?

Dr. ADAMS. Yes.

Senator MCCUMBER. What great damage or injury to the business institutions of the country would be done if we required them to make their returns as of the calendar year, having all make their returns at the same time, even though they may have fiscal years that are different, It would mean simply the closing of their books a second time, would it not? Why should not that be done, to avoid much of that trouble?

Dr. ADAMS. So far as the department is concerned, so far as I am personally concerned, and so far as the Senate is concerned, that would be a simplification of the matter, but the business interests of the country have insisted that that is not good for them; that for different classes of trade and business there is a natural year, the end of which usually occurs when it is possible for them to take inventory, and that to use only the calendar year would be undesirable, in that they would have to make estimates of their profits and would not know the real profits.

For instance, in the milling business, the natural business year ends about July 1, I understand, when the stocks are depleted.

The natural business year of the department store ends about February 1. They are then through with the Christmas season.

I think, personally, that there is much truth in that argument, and that the department had better put up with the vexation connected with it, and the complexities connected with it in order to accommodate business interests.

Senator WATSON. It makes two fiscal years and one calendar year.

Dr. ADAMS. Fortunately, it is a mere mathematical complexity.

Senator WALSH. And trouble in examining the accounts.

Dr. ADAMS. There is nothing substantive involved in any matter on pages 18 and 19, except what I have already told you. There is, of course, involved in that an assumption that the personal-service corporations will be discontinued. That is a matter that you discussed for a time yesterday and said that you would take under consideration later on. Any change that you may make with respect to that will be met with corresponding changes in those sections. Section 206, on pages 19 and 20, has not been changed.

Senator SIMMONS. May I make a suggestion at this time? When this bill comes out, you will find that Senators will want explanations made with reference to revision and changes of the old law into this new one.

The CHAIRMAN. That will be easily furnished.

Senator MCCUMBER. Those changes will be shown in the bill.

Senator CURTIS. They can be shown in the report until it is enacted.

Senator SIMMONS. The point I am making is this: The bill that we report will show what has been taken from the old law and what is new, but what I am saying is you will find Senators who will want to have some explanation of the old provisions as well as of the new provisions, and unless in our considerations we refresh our minds about the old provisions, we may find ourselves unable to answer those questions.

Senator WATSON. My understanding is that we are reading the bill rather for the amendments than for the original sections.

Senator SIMMONS. I wanted to suggest that. We ought not to fail to give consideration to the old provisions, because undoubtedly we shall be asked questions about them.

The CHAIRMAN. Mr. Walker desires to make a statement.

Mr. WALKER. At the suggestion of Senator Watson, I secured the Treasury decisions from the Internal Revenue Bureau, which contained the stock dividend decision and the decision of March 28 of the Supreme Court relative to the basis for determining gain or loss. I have indicated the Treasury's decision on the front page of the document, and have also put a marker in for each one.

Dr. ADAMS. This section 207 was adopted by the House in the belief that a great many important transactions in the way of the sale of capital assets are now being held up or blocked by the heavy rates of taxation. You will

see the effect of it by an illustration. For instance, if a man buys a farm and holds it for 8 years, and it increases in value, and he sells it, all the gain is treated or taxed as of that one year, although in one sense of the word it was accruing during the 8 years that he held it. Still, in that one year his gain puts him in the high surtax class. Under this section a capital gain will be taxed only at the same rate as is applied to corporations, namely, 12½ per cent. That is the theory of the section. It is also pointed out—and this, I think, is the final justification for this section—that it is made applicable also to losses. If, as I personally expect, there are going to be more losses than gains in the future, this provision will be a revenue saver. It will be effective in small transactions where a gain is secured and, by reducing rates it will limit the extent of loss deductions in other cases.

Senator CURTIS. No man makes a sale of that kind unless he feels he is justified in paying the tax.

Dr. ADAMS. That is the point. Thousands of these sales are now being held up.

Senator CURTIS. Your idea is to relieve that situation?

Senator MCCUMBER. It applies to all classes of property?

Dr. ADAMS. To capital property.

Senator GERRY. In other words, if an individual sells a house and has a profit on it, it would apply to that?

Dr. ADAMS. It would apply to a house held for profit or investment.

Senator GERRY. Suppose a corporation owns it?

Dr. ADAMS. There is no necessity for applying it to the corporations. They already have a 12½ per cent tax.

Senator SMOOT. Do I understand that if it is an individual all he has to pay is the 12½ per cent corporation tax, and over and above that do you exempt him from paying an income tax?

Dr. ADAMS. You simply set aside from his ordinary income this capital income, and the rate on the capital income is limited to 12½ per cent. The same limit is placed on losses.

Senator SMOOT. That is to say, he makes $10,000 profit on the sale of the house; and upon the $10,000 he pays 12½ per cent and no other tax?

Dr. ADAMS. And no other tax.

Take this illustration: Suppose a man has an ordinary income of $20,000 a year. He sells a farm and makes $80,000. That would give him an income for that year of $100,000. Under existing law he would pay about 30 per cent, on the average, on that. What is proposed is this: Have him set $20,000, his regular income, aside. That is put in one class. Have him set $80,000 aside in another class. Then compute the tax on the ordinary income of $20,000 in the usual way, and on the $80,000 he would also pay 12½ per cent.

Senator SIMMONS. Under the law we now impose, in many cases wouldn't that be less than 12½ per cent?

Dr. ADAMS. He pays a lower tax.

Senator SIMMONS. That is provided for?

Dr. ADAMS. That is provided for, except where losses occur.

Senator SIMMONS. If it is less than 12½ per cent, he pays the ordinary tax.

Dr. ADAMS. It does not apply to anybody having a capital net gain who does not get up above 12½ per cent.

Senator MCCUMBER. That is, when he disposes of part of his capital.

Senator MCLEAN. Would this apply to capital received as a gift?

Dr. ADAMS. That is not taxable.

Senator MCLEAN. Suppose his son or wife sells it. We were worrying yesterday about the enormous tax he would have to pay. This provision applies to that?

Dr. ADAMS. Yes.

"SEC. 207. (a) That for the purpose of this title—

"The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

"The term 'capital loss' means deductible loss resulting from the sale or exchange of capital assets consummated after December 31, 1921.

"The term 'capital deductions' means such deductions as are allowed under this title for the purpose of computing net income and are properly allocable to or chargeable against items of capital gain as herein defined.

"The term 'capital net gain' means the excess of the total amount of capital gain over the sum of the capital deductions and capital losses.

"The term 'capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

"The term 'ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

"The term 'capital assets' as used in this section includes property acquired and held by the taxpayer for profit or investment (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

"(b) In the case of any taxpayer (other than a corporation) whose ordinary net income and capital net gain together exceed $29,000, there shall be levied, collected, and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows."

That is put in there merely because at about $29,000 the rate becomes approximately 12½ per cent. Anybody who has less than that is paying less than 12½ per cent, anyhow.

Senator SMOOT. I have a long letter this morning telling how unjust this would be.

Dr. ADAMS (continuing reading):

"A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per cent of the capital net gain, or minus 12½ per cent of the capital net loss, as the case may be, but in no such case where the taxpayer derives a capital net gain shall the total tax be less than 12½ per cent of the total net income. The total tax thus determined shall be levied, collected, and paid at the same time and in the same manner and subject to the same provisions of law, including penalties, as other taxes under this title."

Senator MCCUMBER. What is that $29,000?

Dr. ADAMS. That is where the rate gets to be 12½ per cent.

Senator SMOOT. I have several letters this morning calling my attention to this. I did not think we would take it up this morning for consideration, but, in substance, the statement is this, that under this provision if the amount were, say, $29,500, the tax would be over double, just for that $500.

Senator CURTIS. Oh, no.

Dr. ADAMS. I do not think that is true, Senator.

Senator SMOOT. If you want to discuss it now I will go down to the office and get you the figures.

Senator CURTIS. I would like to have Dr. Adams answer that, because it does not seem to me, offhand, that it could be so. I am not disputing your figures, Senator Smoot.

Senator SMOOT. I received it just a few minutes before I came up to the committee room. I have not figured it out.

Senator DILLINGHAM. I would like to have Dr. Adams complete his statement.

Senator SMOOT. That is what I expected him to do.

Dr. ADAMS. In any event, Senator Smoot, we will correct that if that is the effect of it; but I do not think it is, although the House provision needs amendment. [Continuing reading:]

"(c) In the case of a partnership or an estate or trust, the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss shall be determined under rules and regulations to be prescribed by the commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership or estate or trust, and shall be taxed to the member or beneficiary or to the estate or trust as provided in sections 218 and 219, but at the rates and in the manner provided in subdivision (b) of this section."

Senator Smoot, I think your point is covered, and I think your correspondent overlooked a very careful selection of phraseology in lines 23 and 24, page 21, and the word "such," in line 9, page 22. This does not apply to any taxpayer, for instance, unless the ordinary net income and net capital gain exceeded $29,000. For instance, a taxpayer with an ordinary net income of $25,000 and a capital net loss is not touched by this section at all. However, the section should state more clearly the cases of capital loss embraced under its terms.

Senator SMOOT. But if he had $29,500 it would be quite different. I would rather get the letter, because I have not had time to examine into it closely.

Senator SIMMONS. There may be some danger in that.

The CHAIRMAN. I would like to see the letter myself.

Senator SIMMONS. It is one of those matters that generally give trouble.

The CHAIRMAN. From whom is the letter, Senator Smoot?

Senator SMOOT. It is from Reed. There are three letters, I think; but Reed goes into detail.

Senator MCCUMBER. Do you mean Senator Reed?

Senator SMOOT. No; Robert Reed. He has been before us numerous times. He is a very bright attorney.

Dr. ADAMS. Mr. Reed is very keen. He possibly has a point.

Senator SMOOT. I have not studied it. I do not know, but I am going to bring the letter up when we consider this matter.

Senator WALSH. Why is it fixed at $29,000?

Dr. ADAMS. That is where the rate becomes 12½ per cent.

Senator WALSH. But you discriminate in favor of those who have an income of over $29,000?

Dr. ADAMS. We simply say that their tax on capital gain shall not be over 12½ per cent.

Senator WALSH. They can not charge off their loss.

Dr. ADAMS. Not capital net losses.

Senator GERRY. Take the case of a man who sold a building and took a loss of $80,000. Could he only deduct 12½ per cent of the loss?

Dr. ADAMS. Yes.

Senator GERRY. Under the old ruling you could collect 50 per cent. He can not claim any more of a loss than 12½ per cent?

Dr. ADAMS. Any loss of this kind will be taken into account on the 12½ per cent basis. However, the loss provision is strong medicine and should be carefully examined.

Senator MCLEAN. There are men who hold real estate stocks and other things, and they can not use them, and they will not sell them because they have too high a tax.

Senator GERRY. And this will help them out. It is perfectly true that that has stagnated things. There is no question about that in many lines of business.

Dr. ADAMS. Now, coming to page 23, there is nothing new, I think, with relation to the normal tax at this point. The normal tax rates are 4 and 8 per cent, and remain as they were before.

Nor is there anything new on pages 24 and 25. The surtax rates remain as they have been in the past. But on page 28 a new subdivision (c) is inserted at line 16, which provides that—

"For the calendar year 1922 and each calendar year thereafter the rate upon the amount by which the net income exceeds $66,000 shall be 32 per centum instead of the rates specified in subdivision (a) in respect thereto."

In other words, at the present time you reach 32 per cent at $66,000. The House provision is that after this calendar year—in other words, beginning with the calendar year 1922—the surtaxes shall stop at 32 per cent.

Senator CURTIS. I had a letter in reference to that matter complaining very bitterly. The writer suggested something about an income of $65,000; that the injustice was very great to the man that had a very large income as compared with the man who fell just below.

Dr. ADAMS. That is largely a question of policy for you gentlemen. The rates now go up by blocks of $2,000, the surtax rising 1 per cent until you reach about $100,000. All the House did was to shear that off at the expiration of this year.

Senator CURTIS. Have you anything in the Treasury Department that would indicate to the committee at about what time the people began to transfer their money into nontaxable securities in order to evade those brackets?

The CHAIRMAN. In other words, the collection point.

Dr. ADAMS. I think you can figure that out.

The CHAIRMAN. I would like, as one member of the committee, to have that figured out.

Senator MCCUMBER. We have been trying to get that for a year, but have not succeeded.

Senator CURTIS. If you will make a note of that and give it to us at some time during the meetings, I would appreciate it very much.

The CHAIRMAN. I think it is one of the most important things in the bill.

Senator CALDER. I am told that it is between 30 and 35 per cent.

The CHAIRMAN. So have I. I think that is one of the most important points in the bill.

Senator SMOOT. There is no doubt about it. It generally figures a difference between the rate of interest upon tax-exempt securities and taxed securities. I mean the rate of interest in the market is about 32 per cent in favor of one as against the other.

Here is the letter I referred to, Doctor. I have not even had time to read it through.

Senator CURTIS. Why not let the doctor have it and answer it?

Senator SMOOT. I will read it, and then he can see. I do not know how on earth he ever got this provision unless it is in the House bill. This is new, is it not?

Dr. ADAMS. No; it is in the House bill.

Senator SMOOT. He may refer entirely to the House bill.

(Senator Smoot thereupon read the letter referred to.)

Senator DILLINGHAM. Who is the writer of that letter?

Senator SMOOT. Robert R. Reed, of Reed, Dougherty & Hoyt attorneys and counselors at law, New York. Mr. Reed is an attorney who has been before the committee a good many times.

That is the first time I have read the letter through. I just read it before part way. I have not given it any examination. I do not know whether it is right or whether it is wrong, Mr. Chairman, but in passing I just mentioned it.

The CHAIRMAN. I think it is an interesting letter, Senator.

Senator SIMMONS. I suggest that you turn it over to Dr. Adams.

Senator MCCUMBER. Can you see any weakness in the argument, Dr. Adams?

Dr. ADAMS. I do not understand it as read. The one part of it that I understood is wrong. He omits the controlling word "such." On the other hand, there is always a possibility of a loophole, and it ought to be checked. Reed is a very able critic.

Senator SMOOT. Just take this letter. I have not answered it or done anything with it. I have two others downstairs. I have not read them clear through, but they call attention to this very thing, so it is not a matter of one man's criticism.

Dr. ADAMS. They call attention to a different thing, I think.

Senator SMOOT. It may be. I have not read them.

Dr. ADAMS. There was at least one hole in the bill as reported in the House. That hole has been stopped.

Senator SMOOT. It may have corrected the whole of it; I do not know.

The CHAIRMAN. Let the letter be printed.

(The letter referred to, as read by Senator Smoot, is here printed, as follows:)

"I am particularly glad to know that you contemplate an entirely new income-tax measure. It may be of some little help in this work if I outline to you now a few points which I have turned up in my study of the Fordney bill. Although I have always had a high regard for Dr. Adams and for others who have worked on this present measure, it seems to me to be defective in many respects, and particularly to throw open the doors to tax avoidance at the expense of business freedom. I realize the political difficulties involved and do not intend to pass judgment upon this phase of the matter. Briefly, however, there would seem to be no reason why anyone should pay in excess of the 12½ per cent rate prescribed for corporations subject only to the practical value and effect of the proposed new section 220 imposing a 25 per cent additional tax, to which I will refer later.

"Under subdivision (d) of section 202, as amended, it is clear that a business or an individual may incorporate without incurring any tax liability on a capital increment in the business or property transferred to the corporation, and that thereafter the income (including profits on capital increment) may be retained and reinvested in the business of the corporation and finally passed by gift or death without further tax liability.

"It would also be possible for an individual owning, say, mining stock, or any other property which has greatly increased in value, to acquire, for instance, a country estate or other similar property having 'no definite or realizable market value,' and to pay therefor by exchange of his stock or other property, which, having a readily realizable market value, would be taken as the equivalent of cash by the seller.

"Also there is to be no profit when property held for investment or use 'is exchanged for property of a like kind or use.' Broader or more uncertain lan-

guage could hardly be employed. It would seem to make possible the exchange of any security held for investment for any other security. The presumptions, of course, are against the Government. We would seem to be approaching what may be desirable—a practical elimination of any graduated tax.

"We find another angle to the same problem in the proposed new section 207 providing a flat rate of tax or a deduction from tax in the case of a capital net loss or capital net gain. As these provisions stood in the original House bill, with the substitution of $29,000 for $40,000, and 12½ per cent for 15 per cent, the tax on a net income of $10,000 plus a capital net gain of $19,000, total $29,000, would be $3,680. Upon any increase above the $29,000, say $29,500, the tax will drop over $600. Presumably to meet this difficulty a very remarkable provision was inserted on the floor of the House, reading as follows: 'But in no case where the taxpayer derives a capital net gain shall the total tax be less than 12½ cents of the total net income.'

"You will see at once if a man had a salary of $4,000, subject to little or no tax, and then made a capital net gain of $100 or $10 on the sale of an automobile or a row boat he would immediately be subject to a 12½-cent tax on his salary equal to $500. I have not worked out the other variations on this tax as it now stands, but have noted the very serious ambiguity in the use of the term "ordinary net income and capital net gain together exceed $29,000." This is the condition of the application of the capital net gain provisions. The intentions would seem to cover the case of an ordinary net income of, say, $50,000, less a capital net loss of $21,000, leaving an actual net income of $29,000, which would be subject to tax under sections 210 and 211, amounting as stated above to $3,680. But in this case, if the capital net loss was $20,000, net income $30,000, the tax would be computed under section 207 and amount to $6,850. On this view and with different figures, say an ordinary net income of $200,000 with a capital net loss of $171,000 (net income $29,000, tax $3,680, as stated) compared with an ordinary net income of $200,000 and a capital net loss of $170,000 (net income $30,000, tax $81,040 under the present rates, and $57,220 with the 32 per cent limitation) the results, as you will see, are astounding.

"On the other hand, if 'ordinary net income and capital net gain together' does not permit of the deduction of a 'capital net loss'—that is, if on an ordinary net income of $200,000 and a capital net loss of $200,000 the tax is to be computed under section 207—we would have cases, and there are many of them, where the ordinary net income is completely wiped out and the taxpayer penniless and yet subject to tax, figured somewhat as follows: On an ordinary net income of $200,000 (with a 32 per cent limitation) the tax would be $68,470. If there were a $200,000 capital net loss, the 12½ per cent deduction would be $25,000, leaving a tax of $33,470 on a nonexistent income.

"I am avoiding constructive suggestions at this time, but you will no doubt appreciate the practical justice of a very simple provision permitting the taxpayer at his option to segregate his capital items and pay a flat rate on his capital net gain.

"I hesitate at this time to express any final judgment as to the new proposed section 220. The idea of imposing a tax based upon the intent back of a perfectly legal action is a novel one and as a practical measure it would seem to be futile. The presumptions are against the Government, and, assuming that the proposal was upheld in the courts, the cases would be extremely rare where the tax would stand the test of a suit to recover. The proposal practically involves a taking of property under a form of law based upon a finding of the administrator of an intent to do a perfectly lawful act. In some general classes of business there is no practical limit to 'the reasonable needs of the business.' In nearly all businesses there is always an opportunity to use new capital and to reinvest profits in the growth of the business. It is a perfectly lawful thing for a man to incorporate his investments. There have been such incorporations for some years. In the case of such a corporation it would be absurd for a man to distribute his profits and then reinvest them in the corporation."

Senator WALSH. You were on subdivision (c), page 28.

Dr. ADAMS. On page 29 there is nothing new. No change has been made.

Coming to the question of gross income, at the bottom of page 29, lines 23 and 24, in defining gross income it reads:

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid"——

The CHAIRMAN. What caused that to be included?

Dr. ADAMS. What was it put in for?

The CHAIRMAN. Yes.

Dr. ADAMS. It was to take care of salaries and wages paid in kind and not in money. It makes no change in the interpretation of the law. The item stricken out in line 25 is very important: "The President of the United States, the judges of the Supreme Court and inferior courts of the United States," etc.

The CHAIRMAN. I think they ought to be subject to the tax laws. I do not intend to urge it or insist upon it, but my personal opinion is that it is a good example to the rest of the community to have judges and Presidents bear their share of the burden.

Dr. ADAMS. You will recall, in respect to judges, that we have had a decision of the Supreme Court that they can not be taxed when they are in office before the passage of the tax bill. The House decided after a full discussion to exempt the President and all judges. Of course, the only effect of the provision with respect to judges is as to judges newly appointed. [Reading:]

"Including in the case of the President of the United States, the judges of the Supreme Court and inferior courts of the United States, and all other." That is taken out.

The CHAIRMAN. I do not see why the President should be exempt any more than Senators or anybody else. It is a bad example for the community.

Senator SIMMONS. That is very true, Senator. It is a bad example if a judge appointed to-day paid this tax and the judge who was appointed before does not pay it.

The CHAIRMAN. I would waive judges as inconsequential, but the President is not.

Senator SMOOT. I do not think the President would ask for it.

The CHAIRMAN. No; neither would any decent judge.

Dr. ADAMS. In line 4 there have been inserted the words "whether elected or appointed." That has been held by regulation always, but it seemed desirable, while we were changing this part of the law, to put those words in the law. There is no change until you come to line 12, where a very important change is made.

Senator LA FOLLETTE. Beginning with the word "income"?

Dr. ADAMS. Yes, sir. That is line 12, page 30.

Senator SMOOT. That is new, is it?

Dr. ADAMS. It is new and important. That should be italicized just to the end of the sentence. It reads:

"Income received by any community shall be included in the gross income of the spouse having the management and control of the community property."

As you are aware, in some States, I think almost wholly in Western and Southern States there are community property laws by which property acquired after marriage is theoretically, at least, the property equally of the husband and wife, although in practice the husband usually has the control and management of the property to a degree which hardly makes the situation different from that which exists in States not having a community property law.

Senator CURTIS. Under the laws of our State the husband can will only one-half; no more.

Dr. ADAMS. They differ materially.

Senator SMOOT. In my State it is one-third.

Senator CURTIS. No more than one-half. The will is void if the wife elects to take it to law.

Dr. ADAMS. The interpretations of the courts differ considerably, but the Attorney General, when consulted on the matter, held that in those cases the income had to be subdivided; in other words, that income from community property had to be divided between husband and wife for purposes of reporting it for income tax purposes.

Senator CURTIS. Why should that be, when, under the law, the husband absolutely controls the property except that he can not sell it without the wife's signing the deed? The propery becomes absolutely his if the title is in his name, and the children get nothing in the case of her death.

Dr. ADAMS. In any event, the Attorney General decided that for income-tax purposes, the community income, despite the rather large element of custody and control and management in the husband, had to be divided for the purpose of the income tax.

Senator WATSON. The ownership is equal, but the management is all on one side.

Dr. ADAMS. In any event, the effect was to cut in half what would be the ordinary income of a husband in other States.

Senator SMOOT. Do you claim that the right of dower is an ownership?

Dr. ADAMS. It is not a dower. It is something broader than the dower right.

Senator WATSON. They own the property by entirety.

Dr. ADAMS. I do not know whether Utah has a community property law. This is a more sweeping and radical proposition. For instance, suppose the husband accumulates $100,000 worth of stocks or bonds. The income may be divided equally between the husband and wife and reported separately. The surtaxes are computed separately and are naturally very much lower.

Senator GERRY. Who has the fee in these community rights?

Dr. ADAMS. I suppose the so-called community has it, the marital partnership.

Senator GERRY. They both have title?

Dr. ADAMS. In a sense.

Senator GERRY. It is not a dower right, then?

Senator WATSON. Oh, no; not at all.

Senator CURTIS. If the deed or the bond is in the name of the husband, and the wife dies first, the title passes absolutely.

Dr. ADAMS. In many States management of the community income is practically vested entirely in the husband. He can buy clothes and automobiles with it, and in the average State can spend the entire income. He has, in most States apparently, the entire use and enjoyment of the income. It is like the case of the life tenant or annuitant, who, I think, should be taxed on the annual income, although title to the corpus vests in others.

The purpose of this provision is to see that under these community property laws taxpayers shall report for income-tax purposes as nearly as possible as they would in an Eastern State or Middle Western State.

Senator WATSON. Those holdings are called holdings by entirety, and if either the husband or the wife dies the survivor takes the whole; but for the purposes of the income tax the income is divided, although the power of management resides altogether in the husband. That is the law in most of the Western States.

Senator SMOOT. All we have in Utah is the dower right.

Senator WATSON. You have the old law.

Senator SMOOT. Absolutely.

Senator CURTIS. The result would be to reduce the tax, because it is divided between the husband and wife.

Dr. ADAMS. The result of this amendment is to see that in these community property States the person having the custody and control shall report the income.

Senator SMOOT. The whole of it?

Dr. ADAMS. It is desirable to make the income tax uniform in different sections of the United States.

Senator SMOOT. Just the same as it would be if it was an individual owner of the property?

Dr. ADAMS. I ought to say that there is some doubt about the constitutionality of this. It is a very difficult situation. But the management and control, despite the theory, is so broad that it seemed to the House that there was no injustice in saying that the husband in those States should report just as the husbands in other States report. The tax lacks all uniformity if this is not done. Just what income is, for Federal taxation, can not be made wholly dependent upon State laws.

Senator WATSON. The manifest effect would be to increase the taxes.

Dr. ADAMS. I think the House rests its defense on this proposition of uniformity of treatment all over the country.

Senator SMOOT. If there is no constitutional question it ought to be done. I do not see why a man receiving an income, as stated in this amendment, should not pay the same income tax as I would pay under similar circumstances.

Dr. ADAMS. If this provision does not meet the test in the courts, we are in no worse condition than to-day. We simply relapse to the present method.

In lines 24 and 25 there is an important new amendment. The present law reads that there shall be exempt, not to be returnable as gross income, proceeds of life-insurance policies paid upon the death of the insured to individual beneficiaries, etc. That is stricken out. The substantive point is this: Under the present law if a corporation insures an employee it gets no deduction for the

life-insurance premiums which it pays, and if the employee dies and the corporation receives the income, it is taxable on that income. In the case of an individual it is not taxable, and it has been held by regulation that in the case of a partnership it is not taxable.

This limitation was stricken out in the House, and now the proceeds of life insurance policies paid upon the death of the insured will be exempt, whether the beneficiary be a corporation or an individual, under this provision.

There is no change until we get to lines 14 to 21, on page 31, and the only effect of that change is this, that for statistical purposes there was inserted in the revenue act of 1918 a requirement that a person would have to report the number and the amount of the tax-free securities which he held in his return.

Senator McCUMBER. You avoid that now?

Dr. ADAMS. We have stricken it out for purposes of simplification.

The CHAIRMAN. What did you say you did with it?

Dr. ADAMS. It was stricken out.

The CHAIRMAN. Altogether.

Dr. ADAMS. Yes, sir. If it gave any real results I would leave it in, but it does not give you any statistics.

The CHAIRMAN. It was put in there carelessly and without any thought. I remember very well the day it was put in, and I think I suggested it, if I am not mistaken. It was a kind of check on evasions.

Dr. ADAMS. If it gave you a complete statement I think it would be well, but it does not give anything worth the trouble.

The CHAIRMAN. There are some arguments in its favor. One is that it shows who is hiding away all this stuff and in what amounts. But, as Dr. Adams says, it does not work out. I think I had that put in myself, if I remember.

Dr. ADAMS. Your memory is correct, sir.

The CHAIRMAN. I am willing to forego my parentage.

Senator SIMMONS. If it be shown that the income of a man is $100,000, would you allow his claim to stand that so much of that income was received from nontaxable securities, without his making an exhibit or statement as to the amount of nontaxable securities?

Dr. ADAMS. Yes; that is true of all exempt incomes. There is a good deal to be said against not doing so, but there is a good deal to be said for making every taxpayer report all his income and specify it. It is not done, and it is troublesome.

Senator SIMMONS. Would it not be well to require the taxpayer to make an exhibit of the amount of nontaxable securities which he holds and from which he derives income?

Senator SMOOT. I never made a report in my life but what I did it. It ought to be done.

Dr. ADAMS. All the exempt income is exempt, and it is exempt from reporting. I sympathize deeply with what the Senator is saying; but you have got to call for it in every case. You have great groups of tax-exempt incomes, and in many cases the taxpayer concerned feels more interest in not making the return than in not getting the exemption, because in many cases they would have no tax to pay. They want to be relieved of the necessity of making a return.

Senator SMOOT. Suppose a man has a $110,000 income or $104,000 or $105,000 from tax-exempt bonds. He is not required to make any kind of a report at all. He may take chances up to ten or twenty or twenty-five thousand.

Dr. ADAMS. I think what you say is very true.

Senator SMOOT. I say it is a dangerous proposition.

Senator SIMMONS. The sole purpose of that provision was to get correct statistical information, and I think its value was in checking up a man who made the claim that an undue part of his income was due to the ownership of bonds free of tax. He ought, in a case of that sort, to be required to make some sort of an affidavit showing the amount of his income from nontaxable securities.

Senator MCLEAN. Do not the auditors do that now?

Dr. ADAMS. No; we are not authorized to require a return from any person who has not a net income of a specified amount. We can decide what his deductions are, but he need make no return unless we specially visit him.

That is one point; and secondly, we are not authorized to demand in the return a statement of the income which, under this section, is exempt. You made one exception there, and that was the Liberty bond interest.

Senator SMOOT. I would like to strengthen this to make them report all of their income and how many tax-exempt securities are held by them.

Senator WALSH. I think the doctor recommends that—do you not, sir?

Dr. ADAMS. I think you should either direct or authorize—and probably the direction is better—the Treasury Department to require a statement of all exempt income merely as an aid to accuracy and as a check upon the taxpayer.

If you gentlemen think that is too much trouble, all right. But it is very sound in all its effects. Of course, it means trouble.

The CHAIRMAN. Would that throw much burden on the department?

Dr. ADAMS. It would throw a burden on the department and a burden on the taxpayer. That is your real problem.

Senator CURTIS. A simple statement of that kind would not be as troublesome to the department or the taxpayer as the provision contained in the present tax law.

The CHAIRMAN. Is there not some limit to the secrecy surrounding a man's private affairs? I only raise the question.

Senator SMOOT. He has bought those securities to escape taxation. I am not objecting to that at all. But he is a man who is wealthy. He has a big income, and he does not pay any taxes. I think we ought to know where those securities are.

The CHAIRMAN. I have in mind, Senator Smoot, two or three rich men in Pennsylvania who, long before a bill like this was ever dreamt of, never invested in anything but municipal bonds.

Senator SMOOT. Yes; that may be true.

The CHAIRMAN. That was their idea of safety.

Senator SMOOT. To get out of taxation——

The CHAIRMAN. No; it was long before any tax bill was ever dreamt of.

Senator SMOOT. But all the States had them.

Senator WATSON. Suppose you had that knowledge. You would only have the satisfaction of knowing that he had $10,000,000 in tax-exempt securities.

Senator SIMMONS. There is more than that to it. He might make a false statement.

Senator LA FOLLETTE. Might not the statistics be valuable for consideration?

Senator WALSH. For future legislation.

Senator LA FOLLETTE. So as to indicate to legislators how they should deal with this problem of nontaxable securities. It is going to be a matter for very serious consideration some day. If we can get statistics I think we should do so.

Senator SMOOT. There is one question that is being discussed to-day from one end of the country to the other, and that is, How can we make our bonds 100 cents on the dollar in order to know what it is going to cost the Government? To do that we ought to know just where those bonds are, and we have got to know it before we can arrive at what it is going to cost. It would be the wildest sort of a guess to-day.

Dr. ADAMS. You get into a much wider question here. This subject that you are discussing comes in its most important phase, as to whether you are going to require a taxpayer who has no net income to make a return. That has been a matter of long and vigorous dispute in the various congressional committees.

One of the difficulties of this tax-free situation for present statistical purposes is this, that while we require the taxpayer who made a return to specify in great and perhaps unnecessary detail his tax-free bonds, classifying the amount, etc., if all his fortune were invested in tax-free bonds and he had no net income, he made no return at all. That is why the statistics, Senator, are so imperfect.

Senator LA FOLLETTE. But if you require everybody——

Dr. ADAMS. You have got to face the bigger question, then, of requiring everybody to make a return, whether they have a taxable income or not, and that is a major question.

Senator SMOOT. Everybody whose income is above a certain amount.

Senator MCCUMBER. And that will cost $200,000,000 or $300,000,000 to get the information.

The CHAIRMAN. And nobody will read it after you get it.

Senator LA FOLLETTE. How much would it entail, as a rough guess?

Dr. ADAMS. I do not think that it would entail much expense to get a return from everybody. It is a political question more than a question of expense.

Are you going to ask the farmer who made a loss to make a return? Are you going to a fraternal organization and say, "We are going to exempt you, but we want to see what you have got."

We have literally hundreds of thousands of people and organizations that are relieved. They want relief. They have no income tax to pay, but they want to get under the exemption provision in order not to make the return.

Senator McCUMBER. We have 35,000,000 adult persons in the United States, persons who own property or may own property. What is it going to cost you to compel a return from every one of those to see whether they have tax-exempt bonds or not? It is not of much value to you unless you compel everybody to make a return.

Senator SMOOT. Perhaps there are not more than one hundred thousand who have them.

Senator McCUMBER. Those are the ones you want to get at, and not the others.

Dr. ADAMS. Senator La Follette has been interested in this for a long while. The statistics were so imperfect when we got them that I acquiesced in striking this out. There are billions of bonds held by organizations, universities, church foundations, etc., that make no returns, and insurance companies hold large amounts.

Senator SIMMONS. Let me ask you this: Under the present law you permit an individual in the first instance to determine the question for himself as to whether he has a taxable income?

Dr. ADAMS. Yes, sir. The law does.

Senator SIMMONS. If you do that you permit him to decide for himself whether he is entitled to an exemption that he may or may not be entitled to?

Dr. ADAMS. Yes, sir.

Senator SIMMONS. Then you require him to make a statement. Then the Government could check it up and see whether he is entitled to this deduction. I think you ought to see that everybody makes a return. Your total exemption, we will say, is $4,000. If he has an income of $1,000, according to his own estimate, ought he not to be required to make a return so as to show exactly what deductions he is entitled to and so that the department may determine whether the deduction is a proper one or not?

Senator McCUMBER. We had that in one of our previous laws.

Senator SIMMONS. My own judgment is that a large number of people in this country are not making any returns because they are working it out for themselves and claiming that they are entitled to deductions from their income which, as a matter of law and as a matter of fact, they are not entitled to. They are allowed to decide that question for themselves.

Senator WATSON. As to whether they have a thousand dollars net income they decide it for themselves.

Senator SIMMONS. Let them decide it if there is less than a thousand.

Senator SMOOT. They can decide whether to pay any tax if they have a thousand dollars.

Senator SIMMONS. If you let a man determine for himself as to whether he has a taxable income, then you permit him to determine all these disputed questions for himself without any opportunity on the part of the Government to determine whether he has correctly decided those questions.

Dr. ADAMS. The Treasury Department recommended in the strongest way, in connection with the revenue acts of 1917 and 1918, that everybody having a gross income of $1,000 or over should be required to make a return.

Senator SIMMONS. I do not know what position I formerly occupied.

Dr. ADAMS. I remember very distinctly what position you occupied. You occupied the position that you occupy now, but the House opposed you.

Senator SIMMONS. There is one of the very biggest loopholes for the evader of taxes contained in this bill—that is, permitting the taxpayer to decide for himself whether he has a taxable income.

Senator SMOOT. Take a man whose income from tax-exempt securities is $150,000. He has, from some other source, from some other country which no one knows anything about, we will say, an income of $25 000. He receives from an unknown source $10,000. He may make no return and you would not know anything about it.

Dr. ADAMS. Senator, I agree with you. If the committee wants to change this along the lines that you and Senator Simmons suggest, I am only too happy.

Senator SMOOT. It ought to be done.

Senator SIMMONS. Here is a man who sells a farm at a very fine price. You permit him to decide for himself the question of how much profit he made in the sale of that farm. He can reduce it to a minimum if he wants to, and by reducing it to a minimum he has no taxable income. If he were required to make a statement showing that he had sold this farm at a good price, the Government could go and investigate the question and find out whether he had determined that question according to the facts or not.

The CHAIRMAN. Dr. Adams, was the committee of the House of Representatives strenuously set against the retention of this provision?

Dr. ADAMS. Not against this provision, Mr. Chairman.

Senator SIMMONS. I have heard people say, "If you have any doubt in the world about this matter, don't make any return. You don't have to make any disclosure about it."

The CHAIRMAN. Do you think they are unalterably opposed to it?

Dr. ADAMS. Not at all, Senator.

The CHAIRMAN. It was just done in passing.

Dr. ADAMS. It was done to simplify it. If you want to take care of that, if the committee wants me to, I should be glad to frame a proper amendment along the lines that Senator Smoot and Senator Simmons have been speaking of.

The CHAIRMAN. You will encounter a very great amount of opposition.

Senator WALSH. The making of a return ought to be determined by a man's gross income. The requirements for paying the tax ought to be determined by his net income.

Senator LA FOLLETTE. And everybody ought to be required to make a return.

Senator SMOOT. I do not care from what source it comes.

Senator WALSH. Let the Government determine whether they are falsifying or telling the truth about what their income is.

Senator LA FOLLETTE. The time is coming when we are going to need money.

Senator WALSH. There is a great distinction between making a return and paying a tax.

The CHAIRMAN. That is an important point and a high spot in the bill, and you had better reflect on it.

Dr. ADAMS. I will try to cover that point.

Senator MCCUMBER. All you need to do is to say that every person having a gross income over a given sum of money shall make his return under this law.

Dr. ADAMS. If you change the term "net income" to "gross income" I think you will have it.

Senator SMOOT. I think that ought to be done.

Dr. ADAMS. On page 32, lines 2, 3, and 4, there is a change necessitated merely by wiping out Title III, the abolition of the excess-profits tax in the old law; and whereas "Title III" was used, assuming that the excess-profits tax will be abolished and perhaps that title disappear, it was thought desirable to change the language and not the meaning, to make it read:

"To the extent it is wholly exempt to the taxpayer from income, war profits, and excess-profits taxes."

That is a purely verbal change. It makes no change in the meaning. There is no other change on page 32.

On page 33, lines 11 to 15, we have had a provision up to the present time that persons engaged in the military or naval forces of the United States were exempt, reading as follows:

"So much of the amount received during the present war by a person in the military or naval forces of the United States as salary, or compensation in any form from the United States for active services in such forces, as does not exceed $3,500."

That exemption is now wiped out, the war having ceased.

In lines 16 to 21 an important new exemption is authorized, exempting—

"The income of a nonresident alien or foreign corporation which consists exclusively 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 and to corporations organized in the United States.

There has been a good deal of double taxation arising in respect to the taxation of ships and of shipping profits which are very difficult to allocate. It was the belief of the House that the whole situation would be in its best form

if by international agreement or comity each nation would tax its own ships and not attempt to tax foreign ships.

So the exemption was authorized on the basis of reciprocal treatment. If a foreign Government exempts our ships trading there we will exempt their ships trading here. At the present time the more important maritime nations do not attempt to tax foreign ships, but practically confine their taxation to their own ships.

Senator SIMMONS. What amount of tax do we get from this source.

Dr. ADAMS. We do not get a great deal, but in the case of the Cunard Line and several others we get considerable revenue; but their income does not come exclusively from that. They have some other interests, as a rule. If the income has no other element in it except earnings from the operations of ships, it does not apply. We get no great revenue from this source, and we are now attempting to collect from even any steamer that stops in this country, or any foreign vessel which stops in this country and takes traffic except in the most casual way.

It is beginning to arouse retaliatory treatment in foreign countries, particularly in Denmark, Norway, and Sweden. Senator Jones has introduced a measure in the Senate providing for this same thing, only I think it does not do it quite so neatly. It is a nice question for you gentlemen to decide. If this would inspire or bring about an international agreement by which each nation would tax its own ships, it would be a very wholesome thing and would avert a lot of tax rules and a lot of difficulty. I am not so certain that reciprocal legislation of this kind is going to bring that about, but the situation is pretty favorable. There is not much double taxation at present. It is believed that this legislation will avert it. Personally it seems to me, on the whole, wise.

Senator CURTIS. How do you catch those people?

Dr. ADAMS. The ordinary ship that touches here regularly is very easy to catch, but to estimate how much of their profits are earned here is almost impossible.

Here is a steamship line, for instance, that is organized in Norway, we will say. It runs over the high seas, which belong to nobody, and touches at this country and picks up traffic at both ports. How much of its earnings are made here?

Senator CURTIS. Then there are those boats that come to New York and, while waiting for their cargo, make a trip to South America and back to New York, and then go to Europe.

Dr. ADAMS. We go down to the casual tramp steamer that stops here once in three years, perhaps.

Senator LA FOLLETTE. How much revenue is derived from it?

Dr. ADAMS. It is not important so far as the Treasury is concerned.

Senator LA FOLLETTE. It is a source of friction and irritation?

Dr. ADAMS. It is; and it is desirable to avoid international tax difficulties.

Senator SMOOT. In this amendment you say:

"The income of a nonresident alien or foreign corporation which consists exclusively 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 and to corporations organized in the United States."

Suppose they do not grant it?

Dr. ADAMS. Then they will pay the tax. If they exempt our boats which touch at their ports to take traffic from their ports, we will exempt their boats.

Senator SMOOT. It seems to me you could put a proviso in there rather than to put in a new item.

Dr. ADAMS. Item 9.

"Amounts received as compensation, family allotments and allowances under the provisions of the war risk insurance and the vocational rehabilitation act, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war."

That exemption for family allotments, and so on, under the war risk insurance and vocational rehabilitation acts, merely enacts the present regulation of the Treasury Department. The part exempting pensions is new legislation. I do not think any of it is very important. I do not think there will be a hundred dollars in taxes lost.

Senator SIMMONS. Why does the Government want to impose a tax on the money that it gives away in the form of pensions?

Dr. ADAMS (reading). "Compensation received by the President of the United States and the judges of the Supreme and inferior courts of the United States."

Senator CALDER. Some very eminent lawyers have insisted that the President's salary under the Constitution is exempt.

Dr. ADAMS. Not a new President.

Senator CALDER. Any President. Eminent lawyers have told me that the salary of every President is exempt.

Dr. ADAMS. President Harding has come in while the income tax was in force. The same thing applies to new judges. You can not tax an old judge; and the Supreme Court has passed on it. I take it that that would apply to an old President. But in both cases men who are newly appointed while the law is in effect may be taxed.

There remains a nice question as to whether, if you should change the revenue bill, it would be deemed to be new legislation. If, for instance, you change the old income tax and adopt a new law of substantially the same kind, what attitude the court would take toward that I do not know. It is really a legal question whether you may exempt President Harding from the tax applicable to him under the present law.

Senator SMOOT. What if he is reelected?

Dr. ADAMS. Then you can tax him. I think the provision reads that the compensation in the case of a President may not be increased or diminished. Now, the question is whether you can exempt him——

Senator LA FOLLETTE. If you can do one you can do the other.

Dr. ADAMS. Lines 7 to 10: "So much of the amount received by an individual as dividends or interest from domestic building and loan associations, operated exclusively for the purpose of making loans to members, as does not exceed $500."

That is a rather important provision.

Senator WALSH. This is a new provision. They have always been exempt before.

Dr. ADAMS. No; not the interest you receive through a building and loan association. The building and loan association is exempt now, but if you invest in a building and loan association and earn interest there is no particular reason why it should be exempt.

Senator CURTIS. Some of them pay very much more interest than you would get from other investments.

Dr. ADAMS. Not at present.

Senator WALSH. Very few people get over $500 income from them.

Senator MCCUMBER. What is the theory of exempting one's investment?

Dr. ADAMS. To stimulate home building.

Senator SMOOT. A man who invests in a building and loan association does not always do it for home building.

Senator CALDER. That is the only thing that Congress has done to stimulate home building.

Senator MCCUMBER. Therefore, a man who loans to a farmer to buy stock ought to be exempted from the interest that he receives, because it helps him to buy stock.

Senator CALDER. That is the only thing that has been done to stimulate the putting of money into building and loan associations. They loan their money for home building only.

Senator SMOOT. It is just another exemption. A man makes a loan and gets his interest and he is exempt. That is all there is to it.

Senator CALDER. We have tax-exempt bonds issued for the benefit of farmers, but not a dollar to the home builder.

Senator MCCUMBER. Those are Government bonds.

Dr. ADAMS. The only question is a question of policy, and whether it should be retained——

Senator MCLEAN. If you have a thousand dollars in bonds you have got to pay your tax. The nontaxable total of your investment can not exceed $500.

Senator WATSON. The interest can not exceed $500.

Dr. ADAMS. I think these are pure questions of policy, whether you want to grant any such exemption and whether, if it is proper, it should be confined to building associations.

Senator WATSON. A man might have stock in an association to the value of $8,000. At 6 per cent his interest would be exempt. The question is whether or not that is desirable.

Senator LA FOLLETTE. We understand it, at least. Let us move along.

Senator SMOOT. Every member of his family might do the same thing.

Senator CALDER. I am for this, because I believe it will attract deposits in these building and loan associations, and they are all used for home building.

Senator MCCUMBER. They go in for the profit.

Senator SMOOT. They do not go in for home building. Lots of them do, of course, but they make it as an investment.

Dr. ADAMS. Lines 11 to 18 are stricken out merely because the substance of that is introduced elsewhere in connection with the foreign trader and foreign corporations generally. That matter is taken up in great detail in section 217, later.

Subsection (c), lines 19 to 22, reads as follows:

"In the case of a nonresident alien individual, or a foreign trader, gross income means only the gross income from sources within the United States, determined under the provisions of section 217."

That is taken up later.

Coming to "Deductions allowed," section 214 (a):

"That in computing net income there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered;"

This is new:

"Traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business;"

At the present time the Treasury Department requests the taxpayer to make a troublesome list of his expenses abroad on business, and permits him to deduct only the difference between what his expenses would have been at home——

Senator WATSON. That is a single individual, the man who does the traveling?

Dr. ADAMS. It applies only to the person who is traveling, and only on business.

Senator CURTIS. To what extent do you gain on that reasonable-salary proposition?

Dr. ADAMS. We are cutting out salaries where they are not deemed to be reasonable.

Senator CURTIS. You are doing that, are you?

Dr. ADAMS. Yes, sir. There is quite a good deal of criticism from taxpayers. However, the department has been rather active in passing on salaries—I sometimes think a little too active.

Senator CALDER. Mr. Adams, could a Member of Congress come in under that?

Dr. ADAMS. He could after it had passed. A Member of Congress traveling in pursuit of a trade or business would be permitted to make a deduction. He has not been heretofore.

Senator WATSON. Take the instance of a man who lives out at the edge of a city and who goes back and forth to his business.

Dr. ADAMS. We hold that that is not a traveling expense; that is, by regulation. That is touched upon already. Rightly or wrongly we make a distinction between a man traveling regularly between his home and to his work as distinguished to travel away from home.

Senator WATSON. Of course, this is a law. A regulation would not affect that.

Dr. ADAMS. That would be the interpretation we will put on traveling expenses, Senator.

Senator WATSON. It is a question what are "traveling expenses."

Dr. ADAMS. It is a nasty little question, but I think we have too cumbersome a procedure now to be justified by what is involved. I think the proposed amendment to the law is a good thing. We may lose a little money by it.

The next is paragraph 2: "All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from taxation under this title as income to the taxpayer."

The provision denies a deduction for interest on money which you borrow to buy or carry tax-free securities. But we had an exception to that. Hitherto we let you deduct your interest on money borrowed to buy or carry Federal tax-free securities. The Treasury has recommended that that little privilege be wiped out; in other words, that that exception be stricken out, and that this thing be made general.

Passing on to line 17:

"Or, in the case of a nonresident alien individual."

That provision relating to "nonresident alien individual" is taken up in this general section 217; and that is stricken out for that reason.

Next, lines 23, page 35, to line 15, page 36, specify the deductions for taxes, and, as you will notice, the provision is rather long and involved. It seemed possible to simplify that without in any way, as I now recall, changing it; and that changed new matter in lines 16 to 32, page 36, is simply new law in simpler form.

Senator CURTIS. It does not change it at all?

Dr. ADAMS. I do not think it does. [Reading:]

"(3) Taxes paid or accrued within the taxable year except (a) income, war-profits, and excess-profits taxes imposed by the authority of the United States or any of its possessions or of any foreign country and allowed as a credit under section 222, and (b) taxes assessed against local benefits of a kind tending to increase the value of the property assessed."

That is what the old law meant.

Senator WATSON. What does that "(b)" mean?

Dr. ADAMS. That is special assessments; you do not get a deduction for special assessments.

The next deductions relate to losses, and in the first of that there is no change.

Coming to (5), page 37 [reading]:

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States."

That last part of the old law is stricken out, and it is proposed to adopt the following:

"But in the case of a nonresident alien individual or foreign trader only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under paragraphs (4) and (5) for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of the revenue act of 1921, where it appears that at or about the date of such sale or other disposition the taxpayer has acquired identical property in the same or substantially the same amount as the property sold or disposed of. If such new acquisition is to the extent of part only of identical property, then the amount of loss deductible shall be in proportion as the total amount of the property sold or disposed of bears to the property acquired."

Senator SMOOT. That is another complicated thing.

Dr. ADAMS. Men are now selling securities at 10 o'clock in the morning and buying them back at 12 o'clock, in order to claim a loss. The House believed that that should not be permitted. We have had considerable trouble with it, where the taxpayer does that and gets back identically the same securities at the present time. By that change I describe, if you sell first Liberty bonds and buy fourth Liberty bonds, it is different security.

Senator CALDER. Thousands of men go into the stock exchange, sell securities at a loss and buy them back again.

Senator MCLEAN. Last year millions of shares of stock were sold for the purpose of taking losses, and buying them back the 1st day of January.

Dr. ADAMS. They usually do not buy back the same securities.

Senator MCLEAN. The purpose is excellent, but they will get around it by buying securities of a similar nature.

Senator MCCUMBER. Suppose, in July, one buys stock in a company for $100,000, and by January 1 or by December 31 it is only worth $50,000, and he sells it; and then buys it back on January 2. That is $50,000, he is allowed his loss?

Dr. ADAMS. If he has selected different securities.

Senator MCCUMBER. But if he selects the same thing?

Dr. ADAMS. The department is holding it is the identical property; it is a colorable transaction and not a true loss unless he actually surrenders his certificates.

Senator MCCUMBER. I do not know why it would be considered "a colorable transaction" if he has lost that much, if he bought in July when it was worth $100,000 and sold in January when it was worth $50,000.

Senator CURTIS. The men doing that are men with enormous incomes.

Senator CALDER. Not all of them.

Senator CURTIS. Many of them are. One man told me—who was many times a millionaire—that he did that, and that that year he made over $1,000,000; and yet he deducted from his tax where he sold his stock at a loss, gave himself what he was allowed for the loss and turned around a short time later and bought the same stock back at about the same price he sold it for.

Senator MCCUMBER. He has actually lost if the price has actually gone down; so that, on the present value, he has actually lost. What objection can there be to his selling it? He has got to sell it in order to sustain his loss, and what objection is there if he thinks that is coming up if he purchases again?

Senator CURTIS. He may have the stock in a company that he now knows the stock is selling at, say 60, which he knows is worth over $100 a share; sells at 60 and buys it right back within a week at 58 or 61. He has gotten rid of his stock, and he has got all his stock back. Why should he be given credit?

Senator MCCUMBER. It is a bona fide transaction. I could not see why he should not, and I appreciate the fact that about the latter part of December there is for the very purpose of unloading at a loss, and making back again in January. Where a poor fellow has really invested and has to sell, I do not see why he should not have the benefit of it.

Senator CURTIS. If he had to sell he would not buy back the next day or the next week.

Senator WATSON. You said where a given transaction very largely turns on a bona fide transaction. If a man sells for the purpose of taking a loss and buys it back again for the purpose of evading taxation——

Dr. ADAMS (interposing). Would he pay the brokerage charges and get back the stock? If he changes from one form of Liberty bonds to another form of Liberty bonds, or sells United States Steel and buys New York Central, he can take his loss under this provision. I do not think it amounts to a great deal one way or the other.

Senator CALDER. Suppose he should go into the stock exchange, have the sale recorded, and buy it back again and pay the brokerage?

Dr. ADAMS. If you want to recognize that, you ought to do that in a way that will save expense and trouble; permit everybody to inventory their securities at the end of the year. Why force them to put their stock on the stock exchange, and induce them to sell, which always breaks security values? Would it not be better to come right out and say, "Everybody can inventory securities at the end of the year"? You can do this without expense, without starting panics, without getting the December slump which we always have.

Senator SMOOT. We will not do that. There would be no end of trouble that way.

Senator CALDER. Not if you compelled everybody to inventory their stocks at the end of the year.

Dr. ADAMS (reading). "(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual or foreign trader owning property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the commissioner, be accounted for as of a different period."

That provision was inserted because of stray cases where a very great hardship is created if you have any definite or rigid rule on the year in which a loss is to be allowed.

The CHAIRMAN. What was the nature of the case?

Dr. ADAMS. For instance, we had a marine insurance company which ordinarily makes about $50,000 a year. It had, as most marine insurance companies had, a very unusual year in 1918; it did a gross business of about $900,000; it had about $200,000 losses and expenses which occurred in that year plainly. It had in addition a number of indeterminate losses. They knew the vessels were on the rocks or sunk, but they had not paid the losses. They did not know how much of the cargo could be salvaged, and so on.

This loss is probably realized or sustained when the uncertainty is cleared up and the losses paid, but unless this corporation can eventually deduct those losses against 1918 income the deduction will be of little avail. In the ordinary year its income would be insufficient to meet these claims.

We have had a case of this kind. A domestic corporation was directed by a Dutch company to buy a cargo of tobacco and send it to Holland in the year 1917, as I recall it. They bought the tobacco, and then they could not ship it, were prevented from sending it abroad. The American company sold it at a very large profit. That case is in the courts. Is that profit to go to the Dutch company or to the American company? There is a contingent income, and a contingent loss involved. If the American company loses, and the case is decided in the year 1922, the payment will be deducted or accounted for in the year 1922. But it will probably mean nothing to that company in that year, because it is an extraordinarily large item, and it can only be taken care of as against the receipts of an extraordinarily good year.

The point is, where things are held up, by a court decision particularly, we should have some leeway to get it back into the natural year in which it ought to go, because with the variations of profits from year to year it is not the same thing, whether a loss is taken in one year or taken in another year. That insurance company case is a good illustration of that, and I have suggested this language in order to give the department some leeway. I do not wish to disguise the fact that it gives the department much discretion—discretion to take care of the just claims of taxpayers; not to abuse them.

"(7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the commissioner may allow such debt to be charged off in part."

Senator SMOOT. That will open the door wide.

Dr. ADAMS. At the present time we do not recognize a deduction for a debt until the taxpayer wipes it off his books.

Senator SMOOT. I know that, and is not that right?

Dr. ADAMS. It is in my opinion subject to far less control than the use of a debt reserve. You can not go through a taxpayer's debts and actually check off each one and make up your mind whether it is a good or a bad debt. Business is usually so well established that the normal debt loss is pretty well known. If the taxpayer is used to taking one-half or one-quarter of 1 per cent, we can check that.

Senator SMOOT. It will take a lot of revenue off.

Dr. ADAMS. I do not think it will. If you are unreasonable with the taxpayer, he beats you another way; and every time you come out and play fairly with him he tends to become more fair in his accounting with the Government.

The CHAIRMAN. I agree with you; we should rather meet a willing taxpayer than to take the last drop of blood out of him.

Dr. ADAMS. These things are asked for by the American Bankers' Association.

Senator SMOOT. If you allow a bank who has carried a note three or four or five years to make a deduction for it, you do not think it will ever get more than 50 cents on the dollar. It may not get that, and yet something may happen that it will get it all.

Dr. ADAMS. You know what they do now. They write them off, and we never see it, and we never know anything about it. You do not have to wait until the debt becomes worthless before you write it off.

Senator SMOOT. Then you have got to show it on his published statements all the time, that he has written it off and that it is not a resource. This way it would be held there as a resource to the bank, and no bank wants to take off its resources and to pass notes to profit and loss unless it is pretty well convinced it is never going to get anything out of it.

Senator CURTIS. You have had three or four interesting cases in the department where people have charged off notes considered absolutely worthless, men who wanted to pay obligations and who disregarded the statute of limitations, made money during the war, and paid those notes. Those notes had been charged off. Those people came in and paid taxes on those notes afterwards.

Dr. ADAMS. My mind has changed on this opint. I believe that the Government would save a great deal of money, and would have saved a great deal of money, if we had from the beginning authorized the debt reserve, because we would soon learn what it should be. If the taxpayer charges off more than the ordinary percentage, your attention is called to it and the situation is flagged. But when the taxpayer goes in and writes off a lot of bad notes, we have no effective check. I think they sometimes duplicate bad debts, write off and resurrect them and write them off again. The method of reserve is a method we can check.

Senator SMOOT. This does not prevent them from doing that at any time they want to, but it does give them a further right of making a partial claim for a thing that they have not written off entirely, and it does not prevent just exactly what you say.

Dr. ADAMS. Lines 8 and 9 of that page 38 were recommended by me as the suggestion of the American Bankers' Association.

The next is on page 39 and is one which has already been explained in connection with another part.

Senator SMOOT. Excess profits.

Dr. ADAMS. Writing out what Title III means instead of mentioning Title III. There are no further changes on that page.

On page 40, line 6, some changes have been made in the deductions for contributions or gifts.

The CHAIRMAN. I think that is an important section.

Dr. ADAMS (reading). "(11) Contributions or gifts made within the taxable year to"—"corporations" is stricken out and inserted later—"or for the use of: (A) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes."

By oversight that was omitted.

The CHAIRMAN. That ought to be in.

Dr. ADAMS (reading). "(B) Any corporation or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, or educational purposes"—

That is that Cleveland foundation.

Senator WATSON. That is the one Mr. Garfield was down here on?

Dr. ADAMS. Yes. [Reading:] "Or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; or (C) the special fund for vocational rehabilitation authorized by section 7 of the vocational rehabilitation act; to an amount which in all of the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph."

The CHAIRMAN. Where is the provision that permits a corporation to make these gifts?

Dr. ADAMS. That is later on, under "Corporations." [Reading:]

"In case of a nonresident alien individual or foreign trader this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to such vocational rehabilitation fund."

There is no real change in the latter part. That matter stricken out in lines 2 to 5, page 41, is the matter incorporated in the italicized matter I have just read.

Senator SMOOT. The practice has always been to take all of those donations and combine them in arriving at the percentage of the income that they give away to these institutions?

Dr. ADAMS. Yes.

Senator SMOOT. Why did you put these in?

Dr. ADAMS. "Which in all of the above cases combined does not exceed 15 per cent?"

Senator SMOOT. Yes.

Dr. ADAMS. We are putting in some new exemptions—exemptions of gifts to municipalities is new.

Senator SMOOT. It has always been construed that way anyhow.

The CHAIRMAN. Doctor, how did we come to omit in the last revenue bill these gifts to cities and municipalities?

Dr. ADAMS. The point was not raised early enough. It did not come up until we got over to the estate tax. Senator Lodge brought it up, and we put it in the estate tax; but the House and Senate provisions relating to gifts under the income tax were identical, and so no change could be made in conference.

The CHAIRMAN. And that is the reason it was not put in?

Dr. ADAMS. That is the reason it was not put in.

The CHAIRMAN. I am a little surprised, myself, but I did not give some attention to it, because I knew of several very heavy gifts that were protected by this tax, and I wanted to look out for them, and I thought it was in the bill. Henry C. Frick left his art gallery and house to the city of New York.

Dr. ADAMS. That is all right under the estate tax; that is taken care of now.

This new deduction that is authorized here is a deduction in case an individual is forced to realize profits and proceeds immediately to put the profit back into the same kind of property. It became very important during the war. A man would have a boat which cost, say, $100,000, and had come to be worth $500,000 during the war; the boat would be submarined or burned up, and he would get $500,000 and there would be a gain of $400,000. It seemed a great hardship to tax the gain if that man wanted to put the proceeds back into another boat, and in a number of similar cases it is believed that if the taxpayer proceeds to put the money back into the same kind of property that no taxable gain should be recognized.

So, in line 13, page 42, this new deduction is authorized. [Reading:]

"(13) If property is compulsorily or involuntarily converted into cash or its equivalent as a result of (A) its destruction in whole or in part, (B) theft or seizure, or (C) an exercise of the power of requisition or condemnation, or the threat or imminence thereof; and if the taxpayer proceeds forthwith in good faith, under regulations prescribed by the commissioner with the approval of the Secretary, to expend the proceeds of such conversion in the acquisition, directly or through the purchase of stock, of other property of a character similar or related in service or use to the property so converted, or in the establishment of a replacement fund, then there shall be allowed as a deduction so much of the gain derived as the portion of the proceeds so expended bears to the entire proceeds, and the property acquired shall be treated as taking the place of a like proportion of the property converted."

That may be illustrated in this way: Suppose, as I said, a man had a boat which cost $100,000 and it had come to be worth $500,000, and it was burned or destroyed, and he got his $500,000. He would then have a gain of $400,000. Supposing he wanted to take $300,000 of that and put it back in another boat, and $200,000 he wanted to use in the ordinary way. We would say that of the proceeds of his sale four-fifths was gain and that of the $200,000 which he used in the ordinary way, four-fifths should be taxed, but on the $300,000 which he put back into another boat no gain should be taxed, but that boat would stand on his books for purposes of further sale, etc., of course, on the basis of the original cost, three-fifths of the original cost, of course.

Page 43, subdivision (b). [Reading:]

"(b) In the case of a nonresident alien individual or a foreign trader the deductions allowed in subdivision (a), except those allowed in paragraphs 5, 6, and 11, shall be allowed only if and to the extent that they are connected with income from sources within the United States."

Those paragraphs 5, 6, and 11 are paragraphs in which nonresident aliens are specified anyhow. [Reading:]

"And the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the commissioner with the approval of the secretary, which determination shall be final."

The CHAIRMAN. Is not that a very unusual provision to put in the text of the bill? You make the approval of the secretary final?

Dr. ADAMS. It is unusual. But that is a question of so much minutiae and detail that the House thought it ought to go in.

The CHAIRMAN. It is a question of whether it is good practice, legal or constitutional.

Senator CURTIS. It has been decided, Senator, by the courts. They have done that in a number of cases.

The CHAIRMAN. I was only asking information. I never saw it before in a tax bill.

Senator CURTIS. We have done it in other matters.

The CHAIRMAN. In the Department of the Interior I can imagine it being legal, but where it affects the personal property rights of the individual it is another problem.

Dr. ADAMS. The point is, this is one of those problems of detail which it is desirable to settle finally as a matter of detailed fact.

The CHAIRMAN. I can understand what you are driving at, and I can understand how it is to be made final in respect of an oil well or a land claim in the Interior Department, but whether it can be made so in a tax matter affecting personal property rights is another matter. I wish you would look into that. I do not believe you can find another case where it has been made final. I

do not recall it, and I know it has been discussed. The individual has a right to his day in court where it involves property being taken away from him. That is a different proposition from a water right or an oil well right.

Senator WATSON. It is of very doubtful constitutionality and propriety.

The CHAIRMAN. I agree with you.

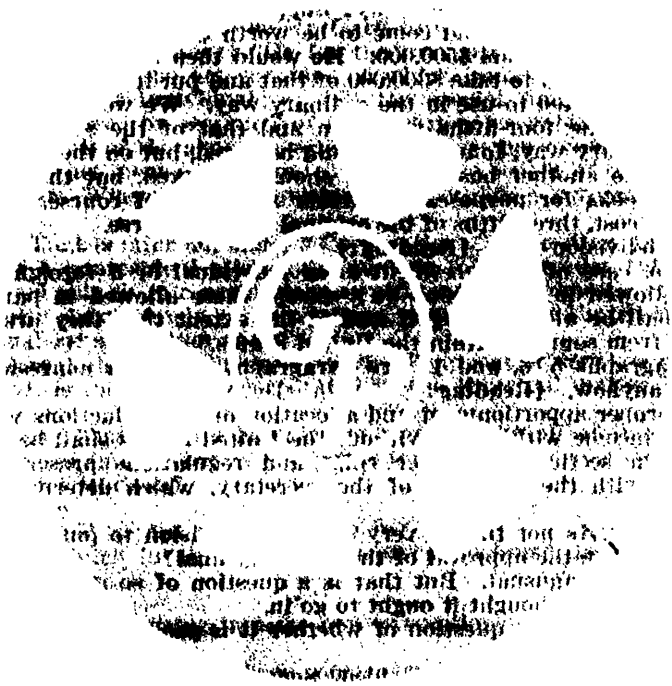
Dr. ADAMS. You will notice it is a very technical matter. To what place items of receipts and expenses should be allocated.

The CHAIRMAN. Better that the Government should lose a million dollars than that it should take a thousand dollars away from a taxpayer unjustly.

Senator SMOOT. That takes us up to the items "not deductible."

The CHAIRMAN. I think this is a good place to stop, and the committee will stand adjourned until to-morrow at 10.30 a. m.

(Thereupon at 1.20 o'clock p. m. the committee adjourned to meet to-morrow, September 3, 1921, at 10.30 o'clock a. m.)



INTERNAL REVENUE.

SATURDAY, SEPTEMBER 3, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, McLean, Curtis, Watson, Simmons, Sutherland, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. J. S. McCoy, actuary, Treasury Department.

STATEMENT OF DR. T. S. ADAMS—Resumed.

ITEMS NOT DEDUCTIBLE.

The CHAIRMAN. The committee will come to order, and we will proceed on page 43. Dr. Adams is present, and we will hear the doctor on items not deductible.

Dr. ADAMS. Section 215, page 43, line 15, and following.

Senator SMOOT. You have put every word of the House amendments in italics, have you not?

Dr. ADAMS. Yes. There has been a small mistake here and there, but practically so.

Senator SMOOT. There are only a few changes.

Dr. ADAMS. Yes. There are no changes on page 43 in this present section, dealing with items not deductible. On page 44 there has been introduced a subdivision (e), line 6, a new provision, relating to a rather difficult subject. You will recall in the case of a person who has a terminable or life interest in property, maybe only the right to receive the income from the principal for the rest of his life, that the right to receive the income is defined for many purposes of taxation as principal. For instance, it is taxed under most State inheritance taxes. An individual A gets a life interest in a block of stock of $100,000, and gets an income of, we will say, $6,000 a year for life. That is capitalized on the basis of the expectancy of the life tenant and is regarded for some purposes as principal or corpus. Naturally that principal or corpus shrinks each year. It becomes exhausted as the person nears the end of his life.

Senator SMOOT. Do you mean the $100,000?

Dr. ADAMS. Oh, no.

Senator SMOOT. Just the $6,000?

Dr. ADAMS. The capitalized value of the right to get $6,000.

Senator SMOOT. That would be the $100,000.

Dr. ADAMS. No. The life tenant only gets it perhaps for 20 years. It is the present worth of the right to get $6,000 a year for 20 years.

Senator SMOOT. You limit it to his life?

Dr. ADAMS. The point is this, Senator: That a number of life tenants in that position have maintained that they had a principal, which principal was merely the capitalized value of the right to get that income, and when that principal shrunk, they were entitled to an allowance for exhaustion under the depreciation allowance, speaking generally. In order to block that, which seems to be a highly vicious sort of thing, because it wipes out what is unquestionably

income, this provision has been inserted. The department holds that at the present time.

Senator McCUMBER. I wish you would just read that and explain it.

Dr. ADAMS (reading):

"Subdivision (e). Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, devise, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time."

Now, Senator, the next is a different point:

"Nor by any deduction allowed by this act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled."

This second point referred to in lines 11 to 17 is this. At the present time, in the case of an estate or trust the law provides that the income of the estate or trust shall be distributed, and the beneficiary, ordinarily speaking, merely pays, if he pays at all, on his distributive share of that income of the estate or trust. Now then, there are great differences in the laws of the various States as to what constitutes income, as distinguished from capital. In some States, as you know, a stock dividend is not regarded as income, in the case of life tenant and remaindermen. In other cases profits or losses on the sale of the corpus itself are not regarded as income.

To take an illustration, suppose an estate has a block of stock of $100,000 and some person is entitled to get the income on that during their life—$6,000 a year, we will say. Now, then, if that block of stock of $100,000 is sold and new stock is purchased, we will say, at a loss of $8,000, that is a loss to the estate under the Federal income tax law; but in many State jurisdictions under State laws it is not regarded as an income item at all, and under such circumstances the beneficiary or life tenant gets the $6,000 right along, regardless of this loss in the corpus itself.

This second section provides that in that case, although the estate or trust to the extent it is taxable—sometimes it is partially taxed and sometimes the life interest is taxed, or may be each taxed in part—the estate or trust may take a deduction, but if under the laws of that State they have got to pay the $6,000 or $5,000 or any such amount to the life tenant that amount shall be taxed to the life tenant, regardless of this deduction to the estate.

Senator McLEAN. Does that apply where the beneficiary takes the whole income from the estate?

Dr. ADAMS. In that case let us assume the beneficiary is taking the whole income.

Senator McLEAN. One beneficiary taking the whole income?

Dr. ADAMS. One beneficiary taking the whole income.

Senator SMOOT. Take a case where the beneficiary does take the whole income and there is that shrinkage of $20,000 and the income also shrinks.

Dr. ADAMS. They are not taxed then.

Senator SMOOT. They are not taxed at all?

Dr. ADAMS. The point is this: Many States have different definitions of income for that purpose from our Federal definition of income.

Senator McLEAN. If you will pardon the interruption, does the beneficiary have any advantage from the loss? Can he offset the loss?

Dr. ADAMS. The point is that the beneficiary is here denied the right to take advantage of that loss, if he gets the income anyhow, only in that case.

Senator CURTIS. If he does not get it, he has that right?

Dr. ADAMS. If he does not get it, he does not pay on it. Suppose this $100,000 corpus is sold at a loss of $8,000, if that affects the income of the life tenant we recognize it, but if it does not affect the income of the life tenant and he draws his $6,000 in cold cash we see no reason why it should not be taxed to the beneficiary.

Senator McCUMBER. Why should we recognize State laws at all? When you make the distinction or definition of what constitutes a loss or gain under the Federal law I can see no reason for making any reference to State laws.

Dr. ADAMS. Well, now, let us take an illustration. Suppose there is a block of stock left in trust for me for my life only. I get no title to the principal,

but I am entitled to draw the income during life, and let us assume it is 6 per cent or $6,000 a year. Suppose that is in a State in which the gain or loss derived from the sale of the corpus is not regarded as income, and there are a number of such States. Suppose that block of stock is in railroad bonds and is exchanged into bonds of the Government of Switzerland, and in doing that the estate or trust sustains a loss of, we will say, $7,000. I get my $6,000 income right along. No attention is paid in my case to that gain or loss resulting from the sale of the corpus. Now, then, under our present law, notwithstanding the fact that I get my $6,000 in cash, I would pay no tax, because I would pay only on my share of the income of the estate or trust, and under the Federal law there is no income to the estate or trust. The $6,000 interest which has been coming to me is wiped out by the $7,000 loss from the sale of the corpus. This will provide, if you want to do it, that in case I do get the money, in case I do get my $6,000 right along, I shall not be permitted to take advantage of that $7,000 shrinkage.

Senator WATSON. Are there many cases of that kind?

Dr. ADAMS. Not many.

Senator MCCUMBER. The party receiving the $6,000, the beneficiary, is not the owner of the corpus at all.

Dr. ADAMS. He is not the owner.

Senator MCCUMBER. No; he is not the owner. All he receives is the interest, or that sum of $6,000 a year from it. That is all he owns. If he receives that, no matter into what form the corpus is changed I can not see the necessity of calling on the State law to help explain the Federal law.

Senator WATSON. Does it not simply mean, practically, that notwithstanding what any law may say or mean this law means just this?

Dr. ADAMS. Would you wish to tax the $6,000 to the beneficiary?

Senator MCCUMBER. Of course.

Dr. ADAMS. You can not do it unless the change is made along this line. That is what we are trying to do.

Senator MCCUMBER. That may be recognized at the law, but if the Federal definition does not define it as a deductible loss—and it does not—then what is the use of dealing with the State law?

Dr. ADAMS. The Federal Government does recognize it, and many States differ.

Senator MCCUMBER. Then simply provide that the Federal law shall not recognize it.

Dr. ADAMS. I do not think you would want to do that, would you? Let us reverse the illustration.

Senator MCCUMBER. I do not understand how you recognize a loss which is a loss to the estate and not a loss to the beneficiary under the Federal definition.

Dr. ADAMS. Except at the present time we recognize it in both places, and therefore, if there is a loss of that kind, although the beneficiary gets the $6,000, he pays no tax.

Senator MCCUMBER. Under the present Federal law?

Dr. ADAMS. Under the present Federal law; because everything turns upon the definition of the income to the estate or trust, and the beneficiary pays merely on his or her share. That is the point about the income to the estate or trust. That arises more frequently in connection with the depreciation—not exactly depreciation, but depletion.

Senator MCCUMBER. The trust or executor would return no income?

Dr. ADAMS. The trust or executor would return no income. They say the estate or trust has no income.

Senator WATSON. On account of the loss?

Dr. ADAMS. On account of the loss; and therefore the beneficiary will pay nothing, because the loss wipes out his share of the estate or trust in amount.

Senator SMOOT. I think that is a fair proposition.

Senator WATSON. I think so, too.

Senator MCCUMBER. It may be fair, but it seems to me very complex.

Dr. ADAMS. It is complex, Senator. I think you are right about that, but the trouble arises because of the different definitions of income between State jurisdictions and Federal jurisdictions.

Senator MCCUMBER. No one on earth would understand what was meant about it unless they had the particular thing before them.

Senator WATSON. The fellow who is involved would have it explained to him what it means, and there are not many of them.

Senator McCUMBER. He will probably hire an attorney—some who have been connected with the department.

CREDITS ALLOWED.

Dr. ADAMS. In "Credits allowed," at the bottom of page 44, there is stricken out lines 21 to 25 of the present law relating to dividends. That is a very important change. At the present time an individual credited for the purpose of a normal tax is credited for dividends received from the corporation which is taxable under that title upon its net incomes. Perhaps I had better read it:

"SEC. 216. That for the purpose of the normal tax only there shall be allowed the following credits:

"(a) The amount received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by acts of Congress."

It is proposed to change that, on page 45, line 1, to read:

"(a) The amount of dividends included in the gross income."

The situation is this: Of course, any dividend received from a domestic corporation is exempt, the corporation having been taxed upon that income. This is important only in connection with foreign corporations. In the case of a foreign corporation, if it does no business in the United States, has no income which is subject to our income tax, then the dividend is taxable to the recipient, and we tax it in its entirety; but if this foreign corporation gets any income at all subject to our tax, so much as a dollar's worth, the dividends paid by that corporation then become exempt to the recipients in this country.

Senator SMOOT. In proportion to the amount they receive.

Dr. ADAMS. We do not proportion it, Senator.

Senator SMOOT. If you do not do that, it may work a hardship.

Dr. ADAMS. It works a most curious result.

Senator SMOOT. I do not see how it could be otherwise.

Dr. ADAMS. Here is what is done: Every foreign corporation which is awake to the possibilities of the situation or is properly advised proceeds to buy American bonds. All it has to do is to get the slightest income in this country from any source. The easy way is to buy a few securities. Then its income is subject in whole or part to our tax, and the dividends which it pays come to the recipient in this country tax free, so far as the normal tax is concerned, and that is all we are interested in here.

Now, the Treasury Department and the committees in past times have been interested in this situation. I have been a little worried about it. I see no easy remedy that does not involve great complexity. You could adopt this prorating proposition, but that is almost impossible. You can not advise every stockholder how to prorate it, the prorating factor will change, the income of the corporation in this country changes, and taking everything into account it was thought that the simplest solution was probably the best solution, and the House committee adopted this proposition.

Senator SMOOT. Why do you not leave it the way it is now? If he still gets his dividends from foreign corporations why should he not pay the American tax upon them, the normal tax?

Dr. ADAMS. The reason is just this, Senator.

Senator McCUMBER. He sometimes pays it to the other country, does he not?

Dr. ADAMS. Yes; but you take a sincere, high-minded corporation, and there are such corporations, and it rather scorns to utilize any device, perhaps, to get its stockholders exempted. I have two cases in mind. I only recall two now, but one is a $300,000 dividend and the other is a $600,000 dividend, by a foreign corporation paid into this country to its stockholders, and taxable.

On the other hand, I have this case in mind, which is an actual case. An American corporation, which is well known, has a foreign or French subsidiary which has made a good deal of money and accumulated a lot of profits. The French subsidiary, or the American corporation, because it owns practically all its stock, wanted to bring back $800,000 to this country, when it discovered it taxable. Suddenly it was discovered that the French subsidiary had $3,000 income in this country that it should have reported on; whereupon the French subsidiary's income became subject to our tax and the $800,000 dividend came in tax free.

Many foreign corporations are quite generous now in buying a little American property of some kind. Some use a few bonds, and therefore become subject

to our tax, and their dividends come in tax free. In other words, under the present law you practically get in amount no revenue from foreign dividends of any foreign corporation which do as much as buy a Liberty bond or a single railroad bond and thereby secure exemption for stockholders in this country. If you happen to get any, it is sheer accident.

Senator SMOOT. Is that on account of any law we have passed?

Dr. ADAMS. Read the old law and you will see where it is.

Senator SIMMONS. Let us read it.

Dr. ADAMS. The old law is on line 21 of page 44. It begins at line 18 of page 44, and reads:

"CREDITS ALLOWED.

"SEC. 216. That for the purpose of the normal tax only there shall be allowed the following credits."

The first credit is:

"The amount received as dividends from a corporation which is taxable under this title upon its net income."

The department has held that means taxable in whole or in part. I do not see any other construction to be placed on that. As a matter of fact, we held, against legal advice, largely on my recommendation at one time, that there was some prorating proposition that should be made, but that has not stood up. The lawyers unanimously agree that you can not put in any prorating system.

Senator SMOOT. Do they escape the foreign tax?

Dr. ADAMS. No; they pay the foreign tax.

Senator SMOOT. This same thing came up when we had this section up before. There was a French company and also a Canadian company.

Dr. ADAMS. Oh, you will have a lot of it.

Senator SMOOT. I thought we had it fairly satisfactory to all of them. There is a rule now that if they have only a few bonds it becomes taxable.

Dr. ADAMS. Yes; of course you will have to remember that each receives the income. The foreign corporation is subject to its own income tax. If you get the tax you get a double tax in a sense.

Senator SMOOT. If that is the rule practiced by the department, why change it?

Dr. ADAMS. I was only suggesting, or the House suggested, an amendment which practically simplified the law, because under the present practice all the foreign corporations are getting a little income in this country. They buy a bond or two and get a few hundred dollars subject to our tax.

Senator WALSH. It is to prevent foreigners from resorting to devices of that kind to escape the tax.

Dr. ADAMS. Yes. I have had an experience with one of your constituents, Senator Walsh. He is a very high-minded, scrupulous man. He owns a foreign corporation. He brought in $300,000. I supposed he was aware of that. He has first-class counsel. He is paying his tax, and right alongside of him are hundreds of these foreign corporations coming and utilizing this device. I do not like to see that done.

Senator WALSH. If he buys a share of stock on this side, he would not pay any tax?

Dr. ADAMS. No; if he would have this foreign corporation receive even 10 cents of taxable income from this country.

Senator SMOOT. Then it is taxable under our law only as to the normal tax?

Senator WATSON. Yes. This provides that for the purpose of the normal tax only the credit shall be allowed.

Dr. ADAMS. There is another point. A shyster lawyer discovering this situation, which is perfectly simple and open to everybody, would go around and make a great point of it and charge large fees to advise these large foreign corporations how to get out of it.

Senator SUTHERLAND. As far as this man from Massachusetts is concerned, he should discharge his lawyer.

Dr. ADAMS. His lawyer knows it perfectly well. Many of them who are expertly advised and who know about it rather scorn to do a thing of that kind.

Senator WATSON. This cures that.

Dr. ADAMS. It cures it by saying, "In all cases," etc.

Senator WALSH. It cures it by changing "net income" to "gross income."

Dr. ADAMS. Yes, Senator. It says you can credit for the purpose of the normal tax the amount of any dividends included in his gross income.

I may say this has just been the subject of an international conference on the question of double taxation resulting from conflict of jurisdiction, and that the international conference has recommended this device, the point being that to avoid double taxation, the normal tax shall be applied where the income is entered: if the corporation is taxed in France, that no tax shall be collected where the recipient or stockholder lives. I should not have dared to suggest it on the ground of international comity, although I think that is a good argument, but the reason that has been suggested was to get the amount of revenue.

Senator SIMMONS. My recollection is that why that was written in that way, so as to practically exempt a foreign corporation, was that there was another provision in this bill by which we sought to equalize that advantage, and allow him some exemptions somewhere in this bill to cover that situation.

Dr. ADAMS. Senator, that has been the law from the beginning. We have suggested a number of times and sometimes recommended a prorating scheme, by which that proportion of the dividends would be exempted equal to the proportion of the foreign corporation's net income which is taxed in this country.

Senator SMOOT. I thought that was the plan under this very subhead.

Dr. ADAMS. Owing to its complications we have withdrawn our recommendation in that respect. You have to compare the foreigner's entire net income. Frequently it is a very difficult thing. It is in foreign money. Then you must ascertain the proportions, what proportion of what year. It may differ enormously from year to year, and dividends may be paid out of incomes in all kinds of years. Then the question is how will the stockholders be advised what their proportion is. It is so difficult we thought we should not do it.

Senator WATSON. We would better insert this amendment and refer the question to the League of Nations.

Dr. ADAMS. I was rather surprised that the House committee unanimously adopted this.

The CHAIRMAN. I think we would better let it go to conference.

Dr. ADAMS. I think that might be the solution of it. I wanted to tell you about it, as it is rather important.

The CHAIRMAN. Mark this to be stricken out, so as to get it in conference.

Senator MCCUMBER. What is it you are striking out?

Dr. ADAMS. Subdivision (a) at the top of page 45.

Senator WALSH. I for one do not want to go on record in favor of striking this out.

Senator SMOOT. Leave it just as it is.

Senator SIMMONS. Strike out the amendment made by the House.

Dr. ADAMS. Of course, we really get no revenue from the present law, and it grows less every year.

Senator CURTIS. What would we get from this?

Dr. ADAMS. We could not get anything.

The CHAIRMAN. The only way to get it in conference would be to leave it in.

Senator SIMMONS. Look at (c) on page 45 and you will see what we attempted to do in regard to that. The House has stricken out that provision. It has not only stricken out (a) but has stricken out (c).

Dr. ADAMS. Page 45?

Senator SMOOT. Let us go along and leave it just as it is.

Dr. ADAMS. In lines 9 and 10 there is a substantive change that is made that increases the special exemption for man and wife or head of a family, which has hitherto been $2,000. The House has increased that to $2,500 when the net income is not more than $5,000. To put it in another way, the personal exemption is $2,500 unless the net income is in excess of $5,000, in which case the personal exemption shall be $2,000.

There is this little point about that. I do not say it is sufficiently important to warrant your turning down that change, but I think it should be borne in mind. If a man has an income of $4,999 and he is the head of a family, he gets a deduction or personal exemption of $2,500, but if he gets an income of $5,001, the increase of $2 in the income will increase his taxes approximately $20.

Senator MCCUMBER. Every bracket practically means the same thing.

Senator WATSON. It is one of those arbitrary points we can not avoid.

Senator MCCUMBER. Why not put it as it is in the present law? What is the object of increasing the exemption?

Senator MCLEAN. The object is very clear. If the income is large, he does not need the exemption.

Dr. ADAMS. I think the House felt also that in abolishing the excess profits and reducing the surtaxes some of the smaller taxes should also be reduced.

Senator WATSON. What would be the difference in revenue?

Dr. ADAMS. Mr. McCoy has estimated about $40,000,000.

Senator SMOOT. I think we might take that up later.

Dr. ADAMS (reading):

"A husband and wife living together shall receive but one personal exemption, which shall be computed on their aggregate net income, and in case they make separate returns the personal exemption may be taken by either or divided between them."

Senator CURTIS. That is the existing law.

Dr. ADAMS. That is the existing law, but the amendment would clear up a little doubt in the existing law.

Senator SMOOT. It is a definite statement that it shall be computed on their aggregate net income?

Dr. ADAMS. Yes.

Senator WATSON. What did we agree on the $2,000 and $2,500 exemption?

Senator CURTIS. We have not agreed on anything as yet.

Dr. ADAMS. In line 16 there is another substantive change. The House has erased the $200 exemption for each child or dependent and substituted $400.

Senator SMOOT. Let that go over. What would that cost us?

Mr. MCCOY. $30,000,000.

Dr. ADAMS. In subdivision (e) we had a reciprocal provision reading:

"In the case of a nonresident alien individual who is a citizen or subject of a country which imposes an income tax the credits allowed in subdivisions (c) and (d) shall be allowed only if such country allows a similar credit to citizens of the United States not residing in such country."

Senator SMOOT. That is the Canadian proposition?

Dr. ADAMS. It is a proposition which is highly difficult. We have to follow the foreign law, and sometimes the foreign country has no income tax, and it is changing its laws. Also it seems to me we are very generous to say that a foreign citizen, although he may be receiving only one one-hundredth of his income in this country, shall have his personal exemptions in this country. In order to simplify it and do more justice, the House adopted the provision at the top of page 46:

"(e) In the case of a nonresident alien individual or foreign trader, the personal exemption shall be only $1,000, and he shall not be entitled to the credits provided in subdivision (d)."

I do not see how we are going to work out the present law with that reciprocal provision. You have your $2,500 on some incomes and $2,000 on others. You can not get the foreigner's entire income, and you can not tell whether he has 10 or 4 children.

Senator SIMMONS. Why should a foreigner making money in this country be entitled to exemption?

Dr. ADAMS. There is a good deal to be said on that, Senator, in favor of your suggestion.

Senator WATSON. The only question is that we have a law for our people in Canada which operates the same way.

Senator SIMMONS. That is all right, if you give him exemption on condition that his country allows a like exemption.

Senator SMOOT. That is what this is.

Senator SIMMONS. No; that is what the present law is.

Senator SMOOT. I am speaking of the present law.

Senator SIMMONS. I think the present law is far better than this.

Dr. ADAMS. May I call your attention to the difficulties in the present law? We have to follow it into the foreign country. Maybe the foreign country has no income tax, although it has some tax which is somewhat similar. We have no test of the veracity of the foreign citizen. We can not tell whether he has 10 children or 4 children, or whether he is unmarried or living with his wife. It also means, if you want to administer it with any care and accuracy, that we have to convert the foreign income into dollars in this country. The situation is not important enough to warrant so much meticulous care.

Senator SIMMONS. I think it is better to let both take their chances—the foreigner in this country and the citizen of this country in a foreign country. The foreigner in this country is not entitled, in my opinion, to any exemption under our law; and if one of our citizens goes into another country to make money, I do not think he is entitled to exemption.

Dr. ADAMS. That is a simple solution of it.

Senator CURTIS. That is the way we should do it.

Dr. ADAMS. You will have to remember that the foreigner has invested in this country with the expectation of getting some exemptions. We have our own beneficiaries in other countries to look after.

Senator CURTIS. Let them take their chances.

Senator SIMMONS. We have nothing to do with taking care of the family of a foreigner who comes into this country and invests his money.

Dr. ADAMS. All we ask is that you do not leave this highly complex and difficult provision in the existing law.

Senator SMOOT. *cmf cm cmfcyp*

Senator MCLEAN. I know individuals who have lived in this country 40 years and who are aliens.

Dr. ADAMS. They are treated just like citizens.

Senator SMOOT. There are so many foreign companies doing business in this country.

Senator CURTIS. Will you suggest an amendment that will cover the suggestion made by Senator Simmons?

Dr. ADAMS. All you have to do is to say that nonresident aliens shall not be entitled to personal credit.

Senator WALSH. Do many persons fall within that class?

Dr. ADAMS. We have a pretty large number of foreign investors in this country.

Senator SMOOT. America will get the worst of it.

Senator CURTIS. How will America get the worst of it?

Senator SMOOT. We have so many concerns that have manufacturing plants in Canada. We have them all over the world.

Senator CURTIS. We get our income tax just the same. Our people get the worst of it, and they ought to, if they go to another country to invest. Let them invest in their own country.

Senator MCCUMBER. We get the benefit if they make anything. Why should we prohibit their coming here?

Senator CURTIS. I would not prohibit their coming here, but I would not give them any credit.

Senator SIMMONS. Why should they take money made in this country and carry it to another country?

The CHAIRMAN. That is a very narrow way to look at it.

Senator SMOOT. Our people go into Canada and make these goods, and we get tax on the amount they make.

Senator CURTIS. Let us go on and discuss this when we reach it again.

Dr. ADAMS. It will be a matter of only a few minutes drafting an amendment.

Senator SMOOT. Yes; that is very easy.

Dr. ADAMS. Subdivision (f), page 46, line 5:

"The credit allowed by subdivisions (c), (d), and (e) of this section shall be determined by the status of the taxpayer on the last day of the period for which the return of income is made; but in the case of an individual who dies during the taxable year such credits shall be determined by his status at the time of his death, and in each case full credit shall be allowed to the surviving spouse, if any, according to his or her status at the close of the period for which such survivor makes return of income."

Senator CURTIS. Why do you limit it to the widow? Why not make it apply to children and heirs?

Dr. ADAMS. They are not ordinarily involved. They make their own separate returns. We have no rule under existing law as to what happens if a man has a child born during the year, or if he dies during the year. We have been using this rule. There has been no law for it, and we thought we had better get it in the statute.

Senator CURTIS. Go ahead.

Dr. ADAMS. Line 14, page 46: "Nonresident aliens' allowance of deductions and credits."

That has been stricken out, because that was taken up in the following section. The provision was:

"That a nonresident alien individual shall receive the benefit of the deductions and credits allowed in this title only by filing or by causing to be filed with the collector a true and accurate return of his total income received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title, including therein all the information which the commissioner may

deem necessary for the calculation of such deductions and credits: *Provided*, That the benefit of the credits allowed in subdivisions (c) and (d) of section 216 may, in the discretion of the commissioner, and except as otherwise provided in subdivision (e) of that section, be received by filing a claim therefor with the withholding agent. In case of failure to file a return, the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax."

That was the administrative provision providing how the nonresident alien should get that credit. It is stricken out.

Senator CURTIS. Go ahead.

Dr. ADAMS. On page 47 you come to the matter of nonresident alien individuals and the method of arriving at their income derived from sources in this country. As I told you, we are in a very unfortunate state by reason of the opinion of the Attorney General, and this detail has been put in the law simply to make as precise as it is possible to make this very difficult subject. It reads:

"SEC. 217. (a) In the case of a nonresident alien individual or foreign trader, the following items of gross income shall be treated as derived in full from sources within the United States:

"(1) Interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise (except interest received from foreign traders or foreign-trade corporations), and interest on deposits in banks, banking associations, and trust companies paid to persons not engaged in business within the United States, and not having an office or place of business therein."

Under the present law interest paid by any person, corporate or otherwise, if he is a resident, is subject to our tax. That is the present law. That has been modified to except interest paid by foreign traders or foreign-trade corporations, because they are doing business outside of the United States, and we except deposits in banks in this country held by nonresident aliens who are not doing business in this country, the idea being to encourage deposits in American banks by nonresident aliens. It is usually done as part of some business transaction. There have been requests from many sources and it has been recommended several times in the past by the Treasury Department as an aid generally to foreign and international trade.

"Second. Dividends from domestic corporations other than foreign-trade corporations.

"Third. Compensation for labor or personal services performed in the United States.

"Fourth. Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands franchises, and other like property.

"Fifth. Gains, profits, and income from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located in the United States, and from any sale by the producer of the products thereof.

"Sixth. Gains, profits and income from the sale of real property located in the United States.

"Seventh. Gains, profits, and income from the sale of personal property, both purchased and sold, or both produced and sold by the taxpayer within the United States."

Those are the items which are specifically allocated to the United States, all the profits from which would be taxable here. Subdivision (b) will take care of the deductions that ought to be charged against those items, and reads as follows:

"From the items of gross income specified in subdivision (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States."

Subdivision (c) repeats that almost word for word, but says if the property is outside the United States it shall be allocated without the United States and we shall not tax it.

Senator SMOOT. That would be hard of administration.

Dr. ADAMS. It is done to make the administration clear. We want you to say where they are taxable. If the farm is in this country it is taxable here; if the mine is in this country the profits here are to be taxed.

Senator MCLEAN. Based on your experience, you think it will cover everything?

Dr. ADAMS. Yes; I have no doubt about that point of it.

Senator SMOOT. I was not discussing the principle at all. I said it would be hard of administration.

Dr. ADAMS. It will be very hard. It is the hardest part of the law we have to face. We have to do it now, and we want to make it as easy as possible.

The CHAIRMAN. That will save the members of this committee and all Senators numerous requests from constituents.

Dr. ADAMS. This is altogether in the interests of simplicity and clarity. It takes a good many words, but I think it clears up a difficult point.

Shall I read subdivision (c)?

The CHAIRMAN. I do not see how we can avoid reading it all, line by line.

Dr. ADAMS (reading):

"(c) The following items of gross income shall not be included as income from sources within the United States:

"1. Interest other than that derived from sources within the United States as provided in paragraph 1 of subdivision (a)."

Senator SIMMONS. That is interest accruing to a nonresident and not derived from sources within the United States. Does that not go without saying, that it would not be included in the gross income? What is the necessity of putting that in?

Dr. ADAMS. Some of that does not go without saying.

Senator SIMMONS. Would that not go without saying? Where a nonresident has interest derived from sources not within the United States, upon what theory would that under any circumstances be subject to taxation in this country?

Dr. ADAMS. I think you are right, but you have construed sources within the United States. It is in the present law, and we thought there should be an explicit provision on this. If you think you ought to change it, I will tell you how to change it.

Senator SIMMONS. Where is it?

Dr. ADAMS. Page 47, line 13. It says there:

"In the case of a nonresident alien individual or foreign trader the following items of gross income shall be treated as derived in full from sources within the United States.

"Interest on bonds, notes, or other interest-bearing obligations of residents."

Any interest paid by a resident of the United States, no matter where paid, is taxable in this country. We have this case, for instance: A Canadian corporation, a very large and powerful corporation, which has not one dollar's worth of property or business in this country, came to New York to float a large bond issue; and because it got its money in New York it had to provide a New York office, and theoretically therefore had an office and did business in this country. That is all it had. Yet every dollar of the interest paid on those bonds, although they were paid to nonresidents, and although the bonds were owned by nonresidents, and although the corporation had no property in the United States and did no business here except to maintain a formal office, is subject to our tax.

Senator WALSH. We are not getting it, are we?

Dr. ADAMS. Surely we are getting it.

Senator SIMMONS. This contemplates a case where a nonresident receives an income from interest on a bond due him by a resident, corporate or otherwise.

Dr. ADAMS. Yes.

Senator SIMMONS. He is getting his income clearly from this country. The source is in this country.

Dr. ADAMS. Suppose the resident has all his property outside the United States.

Senator CURTIS. None here at all?

Dr. ADAMS. None here at all. I do not know how to tell you to remedy that. I have thought of it, worked over it, and consulted others about it. I want to say that when you get a situation so difficult you had better be precise. The question is whether we should say just what we want done, and I think we should. I agree with what you say, Senator Simmons.

Senator SIMMONS. I do not understand that. He gets interest from a bond he holds against a resident of the United States. The man is a resident of the United States. It makes no difference where he gets the money from to pay that interest.

Dr. ADAMS. Of course, the common law on that subject is entirely different from what it is here, and the question was passed upon by the Attorney General before this provision was inserted in the law. Under what might be called the natural law interest follows residence, and interest is taxable in the domicile of the recipient of the interest. I want to be quite specific about it, because it is not a subject which goes without saying.

Senator SMOOT. Senator, I think you become confused if you do not read both provisions under this heading. One deals with the construction in the country, and the other with a construction out of the country, and is practically a repetition of this first one.

Senator SIMMONS. The taxpayer does not reside in this country.

Senator SMOOT. That is true. It is a nonresident alien individual.

Senator WATSON. He is not a citizen of the country; he resides here.

Senator SIMMONS. He is a nonresident alien individual or foreign trader.

Senator SMOOT. We are dealing with him entirely. First, he receives an income from sources within the United States, and in the other he receives it from outside the United States.

Senator SIMMONS. Go ahead. I will not make any point about it.

Senator SMOOT. I think it is a doubtful provision.

Dr. ADAMS. Page 49:

"2. Dividends from foreign corporations and from foreign-trade corporations.

"3. Compensation for labor or personal service performed without the United States.

"4. Rentals or royalties from property located without the United States or from any interest in such property, including rental or royalties for the use of or for the privilege of using without the United States, profits, copyrights, secret processes and formulæ, good will, trade-marks, trade brands, franchises, and other like property."

The CHAIRMAN. Doctor, I take it the great bulk of these provisions you are suggesting are the result of special cases of administration called to your attention during the year.

Dr. ADAMS. Most of them are. Most of these provisions we are now dealing with are agreed upon by practically everybody in this field.

The CHAIRMAN. I was just asking about their pedigree.

Dr. ADAMS. That is the situation.

Senator SIMMONS. As a matter of fact, have you not regulations covering these things, and have they not provided just about what these provisions contain?

Dr. ADAMS. The regulations have been in many respects entirely different, under opinions of the Attorney General. It is because of that situation that we feel it should be stated in the law.

The CHAIRMAN. Do you mean the policy of the Attorney General and his view of the law does not harmonize with that of the Treasury Department?

Dr. ADAMS. Not only that, but I think the Attorney General will say he does not think the opinion he gives would be a good solution. He gives what he thinks to be the law, and what probably is the law, but I do not believe he will tell you it is a good law.

The CHAIRMAN. For how many of these provisions, if any, do you find precedent in the legislation of other countries, more particularly England?

Dr. ADAMS. Most of these provisions we are now reading have precedent both in English legislation and in the legislation of our States with relation to income tax. Many persons who get income in the State live outside the State. For the most part, we have followed them.

The CHAIRMAN. We follow them?

Dr. ADAMS. We follow them.

The CHAIRMAN. Have you had those looked up?

Dr. ADAMS. They have been investigated. This has been studied, I suppose, more than any provision in the law.

The CHAIRMAN. There is no doubt of it, Doctor. I just wanted to have expressed for my own mind as to how thoroughly it had been done. It is largely the product of national law, State law, the English law, and the experience of the department?

Dr. ADAMS. Yes. We are in consultation, it might be said, with the Department of State and Department of Commerce, both of which have a very active interest in this particular topic.

Senator McCUMBER. That will bring us over to page 52.

Dr. ADAMS. Do you want to skip that matter?

The CHAIRMAN. We want to go to 52—partnerships and personal-service corporations.

Dr. ADAMS. There is no change in that.

Subdivision (b) at the top of page 53 is a provision of existing law relating to this matter of prorating. I have I had better read it.

"(b) If a fiscal year of a partnership ends during a calendar year for which the rates of tax differ from those of the preceding calendar year, then (1) the rates for such preceding calendar year shall apply to an amount of each partner's share of such partnership's net income equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to the remainder."

That section, which was faulty from the very beginning, was not discovered to be faulty until last year, in conference, and it was then corrected in another section of the law. It should really be abolished. It is modified in section 205. We could not take it out because it had passed both the House and the Senate before it was discovered.

Senator SIMMONS. It says: "Repeal of this subsection to take effect January 1, 1922."

Dr. ADAMS. Yes. The House was repealing it as of January 1, 1922. It ought to be wiped out anyhow.

Senator SMOOT. There may be some corporations whose fiscal year ends in October.

Dr. ADAMS. They do not follow it now. There is a little defect in it.

Senator SMOOT. Then it ought to be repealed on the passage of the act.

Dr. ADAMS. It ought to be repealed at the very first opportunity. It has never been enforced.

Senator McCUMBER. I notice that it says at the bottom of page 53:

"The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212, except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed."

Dr. ADAMS. That is substantive and very important.

Senator McCUMBER. That leaves the right in the partnership to use a portion of its earnings for the purpose of charity, the same as the corporation.

Dr. ADAMS. The same as the individual.

Senator McCUMBER. Yes; the same as the individual.

Dr. ADAMS. In the past it was confined to individuals, and corporations were specifically denied the right. The House changed that policy and gave to corporations the same deductions for gifts.

Senator McCUMBER. I do not believe that any should be allowed. I shall vote against it.

The CHAIRMAN. I think one of the greatest abuses of the war was these international concerns in New York serving their own ulterior ends by using money of individuals to give enormous donations to the Red Cross and other institutions.

Senator McCUMBER. If the individual wants to use his own money for that purpose, that is all right. I do not believe in having the corporations use the stockholders' money for gifts.

Dr. ADAMS. That is a proposition that has required a great deal of our thought.

(Informal discussion followed, at the conclusion of which the following ensued:)

Dr. ADAMS. In order that there may be no misapprehension in connection with personal service corporations, I hope you gentlemen do not think that the high-price chargers are incorporated. They are not incorporated. For instance, the doctors and the certified public accountants to whom reference has been made are not incorporated. In other words, it is a blow in the face to the man who wants to charge high prices to incorporate, whether he is a doctor or an accountant. No one who wants to charge high prices incorporates. I know of but one case where a certified public accountant is incorporated. The high fee of the accountant is like the high fee of the lawyer; it is charged

because of his personal views and reputation. It is a fact that the prosperous accountants do not incorporate.

We now come to estates and trusts.

The changes on page 55 are merely nominal; that is to say, according to line 11, that in dealing with deductions, it is stated "there shall also be allowed as a deduction, without limitation, any part of the gross income, which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside." That is the existing law, gentlemen. I do not know whether you know this or not, but in the case of an estate or trust the entire amount may be set aside for charity. So, similarly, the matter which is stricken out, lines 15 to 24, is stricken out because that applies to everybody at this time. These changes were made in conference last year. They could be made only with relation to estates and trusts. This year they have been placed over in the general provision, so it was unnecessary to mention them in connecton with estates or trusts.

I am not referring to deductions for gifts—that was in the old law—but the deductions for full amounts without limitation.

Senator SMOOT. That is, you want us to strike out lines 15 to 24?

Dr. ADAMS. So that it will read "There shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214."

Senator WATSON. What is that?

Dr. ADAMS. That is the gift provision. We had some special references to estates and trusts. That has been made general.

Continuing, it reads:

"And in cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section, the fiduciary shall include in the return a statement of the income of the estate or trust, which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, wheher or not distributed before the close of the taxable year for which the return is made."

The class of cases described in paragraph (4), subdivision (a), is income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals and the income collected by a guardian of an infant to be held or distributed as the court may direct.

In this class of cases practically alone the income is taxed to the beneficiary. Otherwise the income is taxed to the estate or trust.

Gentlemen, this subject of taxation of beneficiaries, estates, and trusts is exceedingly complex. The changes in the law have been made merely in order to make the present practice more precise. There is no change in the present regulations or practice. I shall be very glad to read this matter if it is desired. It is very technical in nature.

Senator CURTIS. You say there are no changes?

Dr. ADAMS. No material changes, except to state precisely what we are doing.

Senator LA FOLLETTE. There is no use reading it unless some change ought to be made. Have you any suggestion to make?

Dr. ADAMS. As to whether we shall read it?

Senator LA FOLLETTE. No; as to whether a change should be made in the existing law.

Dr. ADAMS. I am going to bring in, when we take up the question of amendments, the question of the change of principle underlying this. The principle is this: In case of an estate or trust the income is taxed to the estate or trust, except in those cases specified a moment ago. Those cases are these: Where the trust itself says the income is to be distributed periodically we tax it to the beneficiary. Then there is another case. In the case of a guardian of an infant, where the court directs it to be distributed we tax that to the infant or ward and not to the trust. In other cases, as a general rule, the tax is upon the income which makes the higher tax.

Now, you asked me whether a change ought to be made. It is worth discussing whether we should change the fundamental principle and say that whenever income is distributed by estate or trust it shall be taxed to the beneficiary. When you come to the question of amendments I shall bring that up.

Senator WATSON. Whether distributed or not?

Dr. ADAMS. No. The point is this. Where a trust is created which leaves it to the discretion of the trustee as to whether the income should be distributed. The

trustee may distribute it. I think it would be a wise provision if a trustee were compelled to advise the department that he is about to distribute the income.

The CHAIRMAN. Anything is desirable, I think, that will simplify the bill and do away with such fearful complications. Would there be a serious difference in the revenues one way or the other if we were to put this bill in simpler form, as you suggest?

Dr. ADAMS. The change that I recommend would slightly reduce the revenue.

The CHAIRMAN. Would it reduce it materially?

Dr. ADAMS. No; I think not.

The CHAIRMAN. I would heartily favor reducing the revenue if we give the law simpler form.

Dr. ADAMS. Very well. When you take up that question I shall bring in the amendment. It is a difficult question.

Senator SIMMONS. Wouldn't it be helpful to this committee if Dr. Adams were to take cases like this where there are changes in the administration of the law and write briefly what the changes are and what the purposes of the changes are, so that we could get at his explanations easily?

The CHAIRMAN. I understood that Dr. Adams is going to furnish a memorandum along that line.

Dr. ADAMS. I shall be glad to do that when you come to report the bill to the Senate.

The CHAIRMAN. Yes; that is what I had in mind.

Dr. ADAMS. If you should take up every point of this kind you would have a whole volume.

Senator SIMMONS. I do not mean every point, but where a whole section is changed I think it would be well.

The CHAIRMAN. That matter was discussed on yesterday, Senator Simmons. I may say to you that a great deal of that will be in the report. It will also be in the form of a memorandum accessible to members of the committee for use on the floor of the Senate.

Dr. ADAMS. I shall be very glad to go into it now in as much detail as you desire.

The CHAIRMAN. I shall be very glad if you would scratch it all out and make it briefer and let the Government lose a little money.

Dr. ADAMS. I doubt if a shorter compass would make for simplification. We had better state exactly what we want done in each one of these cases. You have a whole mass of cases—the question of guardianship, the question of trusts, the question of business trusts, and some of the private trusts with which you gentlemen are undoubtedly familiar.

In that connection, there is a new trust springing up at the present time. I do not know whether you recognize to what extent this particular trust form is succeeding the business corporation.

In Massachusetts, for instance, they organized this form of trust in order to avoid the payment of taxes. The Massachusetts trust has been developed in this country extensively by a method in which you gentlemen may be interested.

Suppose, as an example, you gentlemen had a piece of property—timber land—and that instead of forming a corporation as we know them, you should get together and write up a trust agreement stipulating the form of management, etc., and turn it over to the trustees, who would manage it in accordance with the terms of the instrument written up. It is very common to evidence all that by divisible shares which look exactly like shares of stock. Those can be traded in and sold freely. Nevertheless, under certain conditions, that is not a corporation. What you have is, so far as I can see, practically every advantage of the corporation except limited liability.

The CHAIRMAN. That agency could be used to evade the inheritance tax too, could it not?

Dr. ADAMS. It can be used to evade a great many things.

Senator SIMMONS. Who contracts for such a business enterprise that is so managed, and who is sued?

Dr. ADAMS. The trust is sued. The courts have held that so long as the members or beneficiaries are cestue que trusts and do not retain the right to change trustees at will, that that concern is not a corporation under the law. If they have an instrument evidencing visible shares in the property, if they create a private agreement, or even go further than that, it is a trust; but in the event the certificates or shares carry the right to control the action of the trustees, then the court holds it as fiction; holds that it is in substance an association,

and acts accordingly. But if they refrain from that, they can do everything a corporation can do, and still remain a mere trust.

Senator WATSON. There is the individual liability.

Dr. ADAMS. But in 9 cases out of 10, Senator, that is immaterial.

Senator WALSH. Where is the residence of the trust? Don't they resort to going into States where the law is most favorable?

Dr. ADAMS. This idea originated in your State.

Senator WALSH. I know. It has for its purpose the evasion of State taxes.

Dr. ADAMS. Yes; largely.

Senator WALSH. Don't they have to choose their residence?

Dr. ADAMS. No.

Senator WALSH. A great deal of that is done in Rhode Island.

Dr. ADAMS. Yes. They go down and do it in the Rhode Island courts.

Senator SIMMONS. That being the character and nature of this arrangement, ought we not, in dealing with them, apply those same rules that apply to corporations as to exemptions, etc.? While they are technically not corporations, as a matter of fact they operate as corporations.

Senator MCLEAN. As partners.

Dr. ADAMS. If you should keep the excess-profits tax, I have brought in and have already framed an amendment to treat certain of these trusts as corporations. If you do not have the excess profits tax, they are going to lose by the trust form. They will pay heavier taxes than as individuals.

Senator SMOOT. They will incorporate very quickly then.

Dr. ADAMS. Oh, yes; they will incorporate very quickly then.

I meant by that there is no use going to the trouble of forcing them into corporate form and the trouble of framing a definition, which is a difficult matter, unless we change the excess-profits tax law.

Senator SMOOT. Let us go on with this.

Dr. ADAMS. Do you want to start on page 58—profits of corporations taxable to stockholders?

The CHAIRMAN. Very well.

Dr. ADAMS. Gentlemen, this is an old section which was put in the law for the purpose of penalizing corporations which were organized for the purpose of preventing the imposition of the surtax. The present method of penalizing them is, I think, unconstitutional, and the method has been changed in this section. I will read it:

"SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed"—What I am talking about now was the old method of dealing with them. That is the part that is stricken out—"such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of section 218 in the case of stockholders of a personal-service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member"—Because I feared the methd of personal-service corporation taxation, it was suggested that the following method should be applied—"there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 25 per cent of the amount thereof, which shall be in addition to the tax imposed by section 230 of this title, and shall be computed, collected, and paid at the same time and in the same manner and subject to the same provisions of law, including penalties, as that tax: *Provided*, That if all the stockholders or members of such corporation agree thereto, the commissioner may, in lieu of all income, war profits, and excess-profits taxes imposed upon the corporation for the taxable year, tax the stockholders or members of such corporation upon their distributive shares in the net income of the corporation for the taxable year in the same manner as provided in subdivision (a) of section 218 in the case of members of the partnership. The fact that any corporation is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case unless the commissioner certifies that, in his opinion, such accumulation is unreasonable for the

purposes of the business. When requested by the commissioner or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each."

What this proposed change provides is this:

It deals with a set of corporations which have been formed primarily for the purpose of evading the surtax. It is provided that where that is shown an additional penalty—a tax of 25 per cent—shall be laid upon the corporation, in the first instance, and that the corporation shall be exempted provided all the stockholders of the corporation agree to pay taxes as members of the partnership.

The CHAIRMAN. How do they operate in order to avoid the surtax?

Dr. ADAMS. They form a corporation and do not distribute the income. That is, in my opinion, not an important defect. It has been in the law for a long while and a great deal of attention has been given to it. I do not recall but one case where it has been applied. It is a good deal of a bugaboo, and I do not think it is worth any considerable trouble.

Senator SMOOT. It is made plainer, at any rate.

Dr. ADAMS. I think that what is proposed is a saner method of getting at the situation. I think the other method would be declared unconstitutional almost certainly if it went into court.

Senator SUTHERLAND. You say it has never been used?

Dr. ADAMS. I know of but a single case in which it has been applied.

Senator LA FOLLETTE. It is only applied if the commissioner makes a finding.

Dr. ADAMS. Yes. The commissioner never made a finding.

Senator LA FOLLETTE. That is my point.

Senator SIMMONS. I think a corporation ought to be able to use its undistributed profits. It certainly is an incentive to expansion. I grant that it has been very much abused, in this country, and as I see it the only effective remedy you can apply against that is placing an arbitrary figure for the amount that may be retained.

The CHAIRMAN. We discussed that and it was discovered that each business differs so widely from the others that it was practically impossible to fix upon any amount.

Senator SMOOT. I think we ought to pass a law making it necessary for every concern to keep at least a small part of its profits. Surely something ought to go to surplus. It is the only safety valve they have.

The CHAIRMAN. They ought to be compelled to have a surplus.

(Informal discussion followed, at the conclusion of which the following ensued:)

Senator SUTHERLAND. Why put in there the words "war profits" now, at a time of general peace?

Dr. ADAMS. Because the official name is "excess and war profits tax." Both words are in.

Senator SMOOT. In the law of 1918.

Senator SUTHERLAND. I do not see why there should be the words "war profits."

Dr. ADAMS. That is the name of the tax law. It is "excess and war profits tax." That is the official name of that tax. It is what we commonly know as the excess-profits tax.

Senator SUTHERLAND. It seems to me it ought to be changed in some way to fit the case.

Dr. ADAMS. If we amend the name of the tax law we will make a corresponding amendment here.

Senator SIMMONS. I do not see that there is any objection to that change. I think it strengthens that provision.

Dr. ADAMS. The next is page 60. This relates to the payment of tax at source. The changes are unimportant.

The first change occurs beginning with line 7. Inasmuch as under section 217 we have proposed the changes relating to the net income of nonresident alien individuals and foreign traders it became necessary to provide a tax here that should not be withheld at the source. This is the method of collecting tax in the case of a nonresident alien. We say that it shall not be withheld or collected in advance in lines 15 to 17. The law has been imperfect in the past as to whether we should hold taxable income paid to nonresident partnerships. It is thought desirable to provide that the partnerships should also be taxable.

Lines 16, 17, and 18 are simply dependent upon the change in determining the tax which we discussed this morning.

In lines 16 and 17, page 61, we have inserted the words "or a corporation" to show that if taxable income is paid to a nonresident foreign corporation it should be withheld at the source as it would be in the case of an individual or partnership. That also is a defect in the present law.

There is a simple change which is purely verbal in line 3, page 62, in reference to section 217. That has been changed somewhat with reference to the precise subject which is involved. All those changes are trivial and go without saying.

Now comes page 63, credit for taxes. The credits in this subdivision are credits against tax—dollar for dollar against tax. The others were deductions or exemptions from net income. These, as I have said, are dollar for dollar against tax.

"SEC. 222. (a) That the tax computed under Part II of this title shall be credited with:

"(1) In the case of a citizen of the United States, the amount of any income, war profits, and excess profits taxes paid during the taxable year to any foreign country upon income derived from sources therein or to any possession of the United States."

This credit has been rather substantially changed by law. It has been restricted and at this point it is enlarged. In order that we may impose a tax we must determine whether the income is earned in one foreign country or another foreign country. We can come back to that a little later after seeing the entire thing.

"(2) In the case of a resident of the United States, the amount of any such taxes paid during the taxable year to any possession of the United States; and

"(3) In the case of an alien resident of the United States, the amount of any such taxes paid during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country."

The point is this: In this country we tax residents on all sources. We treat the resident as if he were a citizen. Suppose he is citizen of England, but that he is deriving income from other countries. We give him credit for taxes paid to England, although we are taxing his income here. Now, he is hard hit, because he is likely to be taxed in his own country as a citizen of that country. That has been changed so as not to confine it to the one country, but to permit him to take credit for taxes in any foreign country, provided his home State or country authorizes the same privileges. The reciprocal provision has not been stricken out.

Subdivision (4) is not changed materially. It merely extends credits to the members of the partnership or beneficiary of an estate or trust.

On page 64 there is a substantive and most important change as to credits:

"(5) The above credits shall not be allowed in the case of a foreign trader; and in no other case shall the amount of credit taken under this subdivision exceed the same proportion of the tax which the taxpayer's net income (computed without deducting for any income, war profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year."

The situation there is about this: We now give to a citizen or resident of this country an exemption practically for any foreign income or profit taxes for which he pays. We subject his entire income from all sources to a tax. Then, after that tax is computed, we show what English taxes have been paid, etc., and then subtract that from the American tax. That is subject to this one rather grave abuse: If the foreign taxes are higher than our rate of taxes, that credit may wipe out taxes which fairly belong to this country. For instance, suppose an individual is earning half of his income here and half of his income in England. Suppose he has an income of $20,000 here and $20,000 in England. At 10 per cent he would pay on $40,000 in the first instance. Our share would be 10 per cent, or $2,000. We would compute $4,000 in the first instance and permit him to deduct the English tax. Suppose, however, the English tax rate is twice as much as our rate, then the English tax on half of the income would wipe out our tax. The proposed amendment is that we shall first compute taxes on the entire income and then allow a credit, but that credit shall not be permitted to wipe out a tax properly attributable to the income derived

from this country. It shall not exceed the same proportion of the tax that his income from sources abroad bears to the entire income.

While I do not want to state that anybody has sought to abuse it, we know of instances where big corporations whose income was derived largely from this country have had their tax wiped out, so far as this country is concerned, because the English tax rates are three times as high as ours. Our rate is 10 per cent; their rate is 30 per cent.

Senator SIMMONS. You made that case out so strongly that I do not think it is necessary to go into it further.

Dr. ADAMS. There is nobody ready to object to it. It has been a big hole in the law.

There is now no change in this subdivision (b), and subdivision (c), on page 65, is not changed in any material sense. It simply generalizes. We had a right to call for the information, anyhow.

The changes in subdivision (c) are immaterial.

In subdivision (d) this provision has been inserted:

"If the taxpayer makes a return for a fiscal year beginning in 1920 and ending in 1921, the credit for the entire fiscal year shall, notwithstanding any provision of this act, be determined under the provisions of this section, and the commissioner is authorized to disallow, in whole or part, any such credit which he finds has already been taken by the taxpayer."

We are changing the law relating to this credit. Ordinarily, when the law is changed and the taxpayer has a fiscal year, we first compute the tax on a 12-month basis, under the earlier rate, and then pro rate the months in that earlier calendar year. Then we turn around and compute under the new law for 12 months, and having done that pro rate for the months in the second calendar year. I am now referring to the corporations with a fiscal year running over and where the rates and provisions of law change. That is a good rule. But we had to make an exception here because this credit is so complicated and the changes are so subtle that we felt in this case it was necessary we should depart from that prorating proposition. While this is all right in the case of corporations it is hardly possible in the case of the individual. The individual may get credit for some item twice. In order that you may understand that point better I shall go into it a little further.

In the original act of 1918 this credit was made strictly on a cash basis, although the corporations reported generally on an accrual basis. Now, then, having been safeguarded, as this credit is, it seemed advisable to permit it to be based on an accrual basis. We have changed the theoretical position that a taxpayer might claim credit for some foreign tax paid twice. To prevent that the commissioner has been authorized to disallow it if it is plain that that is being done.

We now come to individual returns, section 223. That section has been modified, beginning with line 22. In order to make absolutely certain what has not been wholly certain—that a man and wife might make a joint return, whatever the size of their income, or might make separate returns—this change has been made. It has been uncertain. We have permitted it, but it is uncertain. It is provided here that "a husband and wife living together may make a single joint return, in which case the tax shall be computed on the combined income." They do not have to do it, it is not compulsory.

There are no changes made in the law on pages 66 and 67, except the one just referred to.

The CHAIRMAN. Take up 68.

Dr. ADAMS. That deals with the cases where the taxpayer changes the accounting period; where he wants to change from the fiscal to the calendar year, or vice versa. No change has been made in that except in lines 19 to 24, where it is provided that.

"In the case of a return for a period of less than one year the net income shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in such period, and the surtax shall be such part of a surtax computed on such annual basis as the number of months in such period is of 12 months."

In order to compute this on a proper basis it is provided that if a man makes a return for a part of a year or less than a year it shall be done in this manner. As an illustration, suppose he makes a return for 4 months. You multiply that by 3. That would then be on a 12 months' basis. You compute the taxes on a 12 months' basis and then take the one-third.

Senator WALSH. Just what is the reason for that?

Dr. ADAMS. They have tried on a number of occasions to break the fiscal year in two. If you have a $100,000 income, you pay a tax of approximately 30 per cent. If you divide it into two parts, the tax would run up to about 20 per cent. Mr. McCoy can tell you exactly what it would be.

As to the time for filing returns, there has been no change made in that.

On page 70 you come to corporation law. The change is substantive and deals with changes in rates, lines 15 and 16.

The present law carries a rate of 10 per cent. The House proposes to keep that 10 per cent rate for the years 1920 and 1921, but after the year 1921 to make it 12.5 per cent. That is a substantive change. It is very simple. We do not have to stop there.

Page 71: These are the exemptions of corporations—corporations that are exempt. The present law gave exemption to fraternal beneficiary societies, orders, or associations, but qualified it with two qualifications.

"(3) fraternal beneficiary societies, orders, or associations (a) operating under the lodge system or for the exclusive benefit of the members or beneficiaries of members of a fraternity itself operating under the lodge system; and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents."

In other words, to get this exemption fraternal beneficiary societies had, first, to operate under the lodge system; and, secondly, to provide for life, sick, accident, or other benefits to the members of such societies or their dependents. That second qualification has been stricken out. As a matter of fact, from what I know I do not think that Congress meant to put two limitations upon that. I think it meant either of these things.

Senator SMOOT. What would be the result of this if you had a fraternal beneficiary society or order or association operating under the law if it were not the general purpose to pay life, sick, or other benefits. Under this law they could operate for any purpose.

Dr. ADAMS. If it is beneficial or fraternal.

Senator SMOOT. Yes.

Dr. ADAMS. As proposed under this lodge system, it would be exempt.

Senator SMOOT. That is what I say.

Dr. ADAMS. It is a substantive change. This would exempt any fraternal organization operating under the lodge system or for the exclusive benefit of members and beneficiaries of members of a fraternity itself operating under the lodge system.

Senator SUTHERLAND. Under the lodge system or for the exclusive benefit of members.

Dr. ADAMS. Yes; you could have either one.

Senator SUTHERLAND. It might operate under the lodge system.

Senator SMOOT. If it is for the benefit of members, they can do any kind of business they want to. I do not think that is right. That is not what the lodge fraternities or organizations are created for.

The CHAIRMAN. What Senator Smoot objects to is the present law.

Senator SMOOT. No. They say here practically that the only thing that the fraternal society or beneficiary society has to do is to have to operate under the lodge system for the benefit of its members.

The CHAIRMAN. "Or."

Senator SMOOT. It does not say "or." If you put in "and"——

The CHAIRMAN. That is the present law.

Senator SMOOT. But under the present law they have got to have this provision for sick, life, accident, and other benefits.

Senator SIMMONS. If it is operating under the lodge system, it does not get the benefits unless it pays the sick and life benefits.

Senator SMOOT. That is the meat of it.

The CHAIRMAN. Why did you strike that out, Dr. Adams?

Dr. ADAMS. That was done by the House committee on the ground that the fraternal organization is the one that you do not want to tax.

Senator LA FOLLETTE. It is not a money-making institution.

Dr. ADAMS. No; it is not a money-making institution. The typical institution of this kind is the Modern Woodmen of the World, and so on.

Senator SUTHERLAND. They all pay benefits.

Dr. ADAMS. Yes; as a general rule.

Senator SMOOT. But there is not any here. They could go to work and organize these societies under this provision and call it a society under the lodge

system for the exclusive use and benefit of the members, and that is all they would have to do.

Dr. ADAMS. If it went out to make money we would say it was not a fraternal organization, of course.

Senator WALSH. What class of society could that bring out?

Dr. ADAMS. That would bring out a so-called fraternal organization which is operating for profit.

The CHAIRMAN. Such as what?

Dr. ADAMS. I do not recall any at the moment.

Senator CURTIS. A legitimate organization of that kind ought to be exempt.

Dr. ADAMS. We have not taxed them, but we have had the hardest kind of task to prove that they were educational institutions. Primarily that was done to let in the bona fide Masonic organizations and Odd Fellows, and so on.

Senator LA FOLLETTE. The House committee were all for it.

The CHAIRMAN. What becomes of a labor organization that possibly spends $10,000,000 supporting men out of employment during a strike?

Dr. ADAMS. They are taken care of now under another heading. They are taken care of specifically.

The CHAIRMAN. That is right. I had forgotten that.

Dr. ADAMS. The Masonic organization is deserving.

Senator CURTIS. They pay sick benefits?

Dr. ADAMS. It is purely voluntary if they do it.

Senator LA FOLLETTE. I think you are mistaken, Senator.

Dr. ADAMS. There is no obligation to do so.

Senator WALSH. Some lodges may.

Senator SMOOT. They do, but I do not know that they have to do it.

Dr. ADAMS. Lines 17 and 18:

"Domestic building and loan associations operated exclusively for the purpose of making loans to members, and cooperative banks without capital stock organized and operated for mutual purposes and without profit."

In one or two States organizations which are absolutely nothing but private investment companies are running under the guise of building and loan associations.

Senator SMOOT. We have one or two in our State. It is wrong to exempt them. They are nothing but banking institutions. I think this amendment is a splendid amendment.

Senator WALSH. We call them cooperative banks.

Dr. ADAMS. There is no change in reference to cooperative banks. That is in lines 19 and 20. There has been a real abuse, gentlemen, in two or three States. They are pure investment companies, and that is all they are.

Senator LA FOLLETTE. And that is taken care of?

Dr. ADAMS. That is taken care of. As a matter of fact, the House made this stronger. The suggestion of the department was that the words "operated primarily for the purpose of making loans to members" be used, but the House changed that to "exclusively."

In lines 23 and 24 there is inserted "and any community chest, fund, or foundation." You gentlemen are familiar with that?

Senator SMOOT. Yes.

Dr. ADAMS. That is inserted, and also the word "literary" in line 25.

Senator SMOOT. Do you think that ought to go in there?

Dr. ADAMS. Yes. You will notice, Senator, in lines 2 and 3, page 72, the words "no part of the net earnings of which inures to the benefit of any private stockholder or individual." It has got to be a public trust, in other words.

Senator SUTHERLAND. You include the Rockefeller Foundation?

Dr. ADAMS. Yes, sir; they are exempt under the old law.

"No part of the net earnings of which inures to the benefit of any private stockholder or individual."

That is a very broad qualification.

In line 25, page 72, there is a very proper extension, I think, of the provision relating to cooperative associations. In the past we have exempted cooperative associations. It reads:

"Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales less the necessary selling expenses on the basis of the quantity of produce furnished by them, or organized and operated 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 purchasing expenses."

In other words, these cooperative associations are pretty nearly as frequently nowadays organized for cooperative purchasing as for cooperative selling, and that is why that has been added.

Senator SMOOT. "Necessary distributing expenses" would be better than "purchasing expens " It would not cost anything to purchase. The cost comes in the distribution.

Dr. ADAMS. That is a good point, Senator—"plus necessary expenses." I do not know that you want "purchasing" or "distribution" expenses, either one.

Senator SMOOT. The cost is in the distribution.

Senator LA FOLLETTE. If you leave in "purchasing," then I think you should put in "distributing."

Dr. ADAMS. Why not say "plus necessary expenses"? It seems to me that the qualifying word makes trouble.

Senator SMOOT. This one does, because it does not cost anything to purchase; it is the distribution of it.

Dr. ADAMS. It is perfectly certain that the general expenses will be used. They may have to have some insurance.

Senator SIMMONS. I think you ought to strike out the word "purchasing."

Dr. ADAMS. Lines 17 to 20: You will notice in line 20, on page 73, the words "personal service corporations." They are now exempt from taxation, the tax being upon the members. If that is changed, we want to rescind that exemption.

Coming to the definition of gross income, on page 74, that is another one of those changes having to do with a foreign corporation and a foreign trade corporation. It is provided in lines 16 to 25:

"In the case of a foreign corporation or a foreign trade corporation, gross income means only gross income from sources within the United States, as determined under the provisions of section 217."

That all turns on the long provision relating to the taxation of nonresident aliens which we discussed this morning.

We come, now, gentlemen, to the deductions allowed corporations. We have already been over that matter of deductions allowed individuals. The changes that are coming here are practically identical with the changes that we have already been over, except in a few places, and those places have not been changed. There is no use in going over it again. We have had those changes.

In lines 15 and 16, page 75, the change is in the identical words with respect to individuals.

Senator WALSH. Why do you not put in heading, reading "deductions allowed to corporations"?

Dr. ADAMS. That might be well. Your point is a good one, Senator.

Senator SUTHERLAND. Why should exemptions be allowed in these cases?

Dr. ADAMS. Lines 15, 16, and so on?

Senator SUTHERLAND. Yes.

Dr. ADAMS. The only change we are making there is in lines 15, 16, and 17. This has to do with interest paid by the taxpayer on money borrowed for the purpose of buying tax-free securities. This provision provides that you shall not make a deduction for interest which you pay on indebtedness borrowed or carried to buy tax-free securities. That has been the old law. There was one exception to that. We made an exception of Federal tax frees. The Treasury Department says: "Wipe out the special exemption. We do not want any deduction allowed if you borrow money to purchase and carry Federal tax-free bonds." That is what is done by striking out the parentheses in lines 15 to 17.

Senator SUTHERLAND. On page 76?

Dr. ADAMS. No; page 75. I beg your pardon, sir.

Senator CURTIS. If they are the identical amendments which we have discussed, what is the use of discussing them again?

The CHAIRMAN. Of course, I want to revert to the gifts to charity at the proper time.

Dr. ADAMS. We will come to that, Senator. The change in paragraph 2 is identical with the similar change made in the case of the individual.

The change made in paragraph 3 is identical, except one point. Down at lines 23, 24, and 25 there is a change which has no reference to individuals. There is a proviso as follows:

"*Provided*, That in the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title or any

other tax paid pursuant to the contract or provision referred to in that subdivision shall be allowed."

There is added to that "nor shall such tax be included in the gross income of the obligee."

The situation is this: In the case of tax-free covenant bonds in which the debtor corporation undertakes to pay the tax imposed you have a provision of law that the debtor corporation shall pay a 2 per cent tax. It pays that for and on behalf of the owner of the bond. The present law provides that where the debtor corporation under those circumstances pays 2 per cent for or on behalf of the owner of the bond that he, having paid it for somebody else, shall take no deduction for it at all. That is the old law. But there has been a very nasty little question involved as to whether after all that tax which he pays for the bondholder was not real income and ought not to be included in the income of the creditor or bondholder, the obligee, and the regulations so hold.

In order to take care of that provision, which is highly irritating and not responsible for any revenue, usually "honored more in the breach than in the observance," it is specifically provided here: "Nor shall such tax be included in the gross income of the obligee."

This is a point which concerns only corporations. It does not affect individuals.

There is no change in the next one. Paragraph (4) is identical in the case of the individual. So also is paragraph (5), lines 15 to 19. So also is the change in lines 20 to 24.

On page 78 the dividend exemption is a thing which we discussed. In the case of the individual it is identical.

The changes in lines 22 and 23 are identical with the similar amendment in the case of an individual.

There is no change on page 79.

On page 80 paragraph (10) is stricken through, because that paragraph is abolished to take effect January 1, 1922.

That is for this reason: At the present time insurance companies are subject to the income tax, the ordinary income tax; and this subdivision (10), lines 4 to 11, page 80, refers to that. A new method of taxing insurance companies has been adopted by the House, a completely new method, the details of which are given later on. Because the new method has been adopted to take effect January 1, 1922, this old provision of the law was stricken out so far as it relates to insurance companies. The change is not made effective until January 1, 1922.

The same thing applies to lines 12 to 23 on page 80. These are special provisions relating to insurance companies, which are changed because they are all gathered up into a general method later on in this bill.

The same is true of lines 24 and 25; and it is true of everything down to line 13, page 81. There is no further change on that page.

On page 82, Senator Penrose, you come to contributions by corporations. This is new; and I will read it. This gives a deduction for—

"Contributions or gifts made within the taxable year to or for the use of (A) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes; (B) any corporation or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; or (C) the special fund for vocational rehabilitation authorized by section 7 of the vocational rehabilitation act; to an amount which in all of the above cases combined does not exceed 5 per cent of the taxpayer's net income as computed without the benefit of this paragraph. In case of a foreign corporation or foreign trade corporation this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to such vocational rehabilitation fund. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the commissioner, with the approval of the Secretary."

Senator SMOOT. Have you noticed section 7 of the vocational rehabilitation act since the passage of the last law?

Dr. ADAMS. I have not, Senator.

Senator SMOOT. You had better do that. Since the consolidation of the Vocational Rehabilitation and the Bureau of War Risk——

Dr. ADAMS. I take it that you do not want to stop over this. You want to take it up later?

Senator SMOOT. If you will look it up, I will not.

Dr. ADAMS. I will do that, Senator.

Senator SMOOT. If you do not. I want to, because I am inclined to think that there was a change in that section.

Senator CURTIS. What does line 9 mean—"taxpayer's net income," etc.?

Dr. ADAMS. That is the corporation. This is giving a deduction to a corporation for charitable contributions which it makes.

Senator CURTIS. The taxpayer means the corporation?

Dr. ADAMS. Yes, sir; and the corporation can take a deduction up to 5 per cent of its net income.

Senator CURTIS. It would be better to say "Federal taxpayers."

Senator MCLEAN. Or "the corporation's" net income.

Senator SMOOT. The corporation is the taxpayer.

Senator MCLEAN. That is what it means, of course.

Dr. ADAMS. Paragraph (16) is identical with the similar deduction allowed to individuals. It is a case of compulsory realization of profit, where a person proceeds immediately to reinvest them in the same kind of property.

On page 84, in lines 19 and 20, there are the words "which determination shall be final."

That is precisely the same as individuals, and the committee wants to consider it later on.

On page 85 you have credits for foreign taxes which you remember I discussed this morning, and Senator Simmons said I had explained in enough detail. The changes on pages 85, 86, and 87 are identical, down to page 88, line 11. They are identical with the provisions relating to individuals limiting those foreign credits.

As to lines 12 and 13, you have not had the same thing, but it is entirely in harmony—

"For the purposes of this section a foreign trade corporation shall be treated as a foreign corporation."

That denies to the foreign trade corporation the benefit of this credit.

In corporation returns there is no change.

In the provision for consolidated returns, on page 89, there is an important change—

"SEC. 240. (a) That corporations which are affiliated within the meaning of this section may"—in other words, the consolidated return is made optional after January 1, 1922—"for any taxable year beginning on or after January 1, 1922, make separate returns or, under regulations prescribed by the commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such returns."

There is stricken out the proviso, gentlemen, which had reference, I think, only to "war babies." Shall I read that proviso which is stricken out?

The CHAIRMAN. What was that, Doctor?

Dr. ADAMS. The privilege of making the consolidated return was denied to corporations which were organized after August 1, 1914, the notion being——

The CHAIRMAN. Yes. That is all stricken out, is it?

Dr. ADAMS. I have stricken it out, because I do not think it has any meaning if the excess-profits tax is abolished. If the excess-profits tax is retained the consolidated return should be made compulsory. In other words, the consolidated return prevents abuse of the excess-profits tax. If the excess-profits tax is abolished the consolidated return either has no effect on the taxes or benefits the corporation altogether and wholly and solely. In that instance, as some corporations, despite the fact that they may benefit from it, dislike the trouble and complexity of it, I want it to be made optional. I do not want it optional if the excess-profits tax is retained. It prevents abuse and also relieves the taxpayer. If the excess-profits tax is abolished the consolidated return either makes no difference in the revenue or helps the taxpayer. I think you may well make it optional. In other word, let the corporation elect not to make a consolidated return if it wishes to.

I can further explain the reason for that if you desire it. There are a few cases where the consolidated return is very, very troublesome—a good many

cases—and although a corporation, if it should have a loss in one of its subsidiaries, would stand to gain by the consolidated return, there are a number of corporations that would prefer not to make the consolidated return.

On page 90, lines 10, 11, 12, and 13 read:

"If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the commissioner."

The change in lines 22 to 25 relate to the excess-profits tax, and this is stricken out on the assumption that the excess-profits tax will be abolished. It has no meaning if the excess-profits tax is abolished.

On page 91, lines 8 to 23,, a provision is stricken out which is the most highly complicated provision of income taxation that I ever saw. It becomes entirely unnecessary and meaningless if you make the change in dividends that we discussed to-day.

As I say, it makes possible the elimination of the most complex provision of the existing income taxation. It has no meaning at all if you adopt the change with respect to dividends that we discussed this morning.

I do not think we want to go through it. It is the worst thing in income taxation. It simply provides for a situation that will not exist if you treat dividends as has been suggesed here.

Senator SMOOT. That brings us down to the heading, "Time and place for filing returns."

Dr. ADAMS. Yes, sir. That is a rather important matter in subdivision (*c*) at the bottom of page 91. [Reading:]

"(*c*) For the purposes of this section a foreign-trade corporation shall be treated as a foreign corporation: *Provided*, That in any case of two or more related trades or businesses (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the commissioner may consolidate the accounts of such related trades and businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses."

That is for this purpose, gentlemen: At the present time it is possible—and I am afraid the device is being used increasingly—to incorporate a subsidiary and throw the profits one way or the other. If that subsidiary is a foreign corporation you can throw the profits to it; in other words, by selling products to it at artificially high prices. We have got to have some way of stopping that. The best way to stop it is to find out whether it is wrong for that subsidiary to consolidate its accounts with the parent corporation. This provision gives the commissioner power to do that, although not to tax them as a consolidated concern.

Senator LA FOLLETTE. Simply to test it?

Dr. ADAMS. To ascertain whether the accounts have been properly carried. it becomes very necessary, if you make this dividend change that you spoke of. You have got to know that they are not milking the subsidiary.

Subdivision (d), page 92:

"Corporations which are affiliated within the meaning of this section shall make consolidated returns for any taxable year beginning prior to January 1, 1922, in the same manner and subject to the same conditions as provided by this act as in force prior to the passage of the revenue act of 1921."

That is merely to see that while the excess-profits tax is in force for this year the consolidated returns shall be required as they are at the present time required, and that this optional business of the consolidated returns shall not take effect until January 1, 1922.

Senator SMOOT. If you will turn back to page 35, paragraph (2) of section 214(A), under the heading "Deductions allowed," on lines 14, 15, and 16 you have stricken out these words: "Other than obligations of the United States issued after September 24, 1917." Will not that increase the rate of interest on Liberty bonds; that is, to a person who has purchased Liberty bonds and is paying 6 per cent to the bank to carry them, and the bonds are only drawing 4¼ per cent?

Dr. ADAMS. No; you can do that now, and you can under the present law.

Senator SMOOT. But you say you can not do it under this act?

Dr. ADAMS. The only thing that is stricken out is the absolutely tax-free obligations of the United States—the 3½ per cents and the tax-free Victories.

Senator SMOOT. There would be the 4¼ per cent Victory bonds.

Dr. ADAMS. Only the tax exempts. The four-and-three-quarters are not tax exempt. It is only the three-and-three-quarters that are tax exempt. If you borrow money under existing law to buy those bonds, your interest which you receive is exempt from taxation, and also you deduct the interest which you pay. This law does make that substantive change with respect to the interest which you pay to carry such bonds. Not the other Liberties. The other Liberties are theoretically subject to taxation.

Senator SMOOT. Under this provision, with these words out, it is going to be mighty hard on the man who has borrowed money in carrying those bonds.

Dr. ADAMS. That is a question of policy. You can borrow all the money you want to buy Liberty bonds if you buy taxable Liberty bonds; but if you borrow money to buy the two big classes of tax-exempt Liberty bonds, then you would be denied the right to deduct that interest.

Senator SMOOT. People have been paying interest on their money at 6 per cent and carrying those bonds right along. The State of Utah purchased more than they ought to have purchased. They went away above all of the amounts assigned to them for purchase. They went perfectly "nutty" on it. They went to the banks and borrowed money, and they are carrying them. They have been paying that difference on those bonds and carrying nearly every issue, and they are up against the proposition, if this is effective, that they can not even take an exemption for it now. It is only another hardship upon them.

Dr. ADAMS. Is it not true that very few people bought any tax-exempt bonds?

Senator SMOOT. They did out our way. The three-and-a-halfs were issued, and we all bought them.

Dr. ADAMS. I bought three-and-a-halfs; but, like everybody else whose tax rate is low, I sold them.

Senator SMOOT. That is the trouble. They did not. They are carrying those bonds now.

Dr. ADAMS. It is a question of policy altogether.

Senator SMOOT. I know it is, but I wanted to call your attention to it.

Dr. ADAMS. The Treasury Department recon ended originally that Federal obligations be exempt. We feel that if money is borrowed and used to carry tax exempts, whether State tax exempts, or municipal tax exempts, or Federal tax exempts, you ought not to give a man a deduction of the interest for it. I do not know that they feel it very strongly. We feel there is a difference in those two issues.

The CHAIRMAN. We have reached the subject of insurance companies, where very radical innovations are made in the bill, and we might as well suspend at this point until Tuesday.

(Whereupon, at 1 o'clock p. m., the committee adjourned until Tuesday, September 6, 1921, at 10.30 o'clock a. m.)

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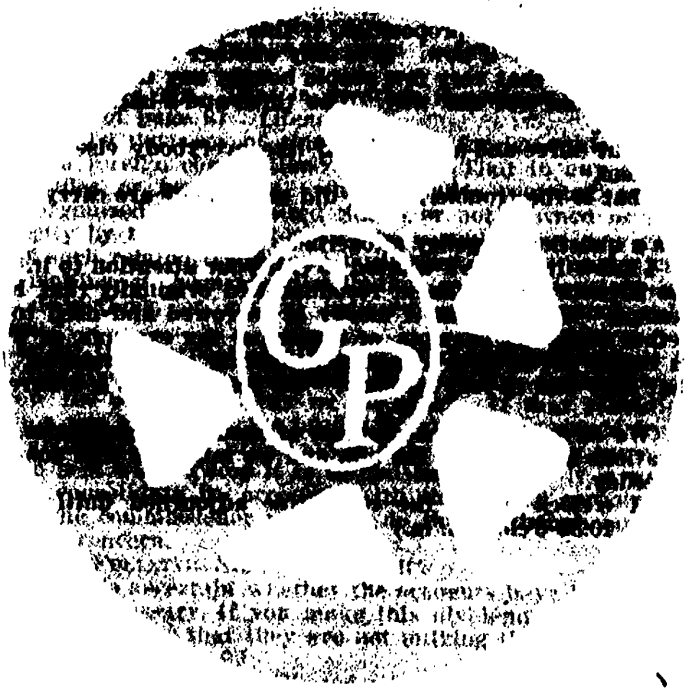


INTERNAL REVENUE.

TUESDAY, SEPTEMBER 6, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chariman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Sutherland, Calder, Reed, Walsh, and Simmons.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate, and Mr. J. S. McCoy, actuary, Treasury Department.

STATEMENT OF DR. T. S. ADAMS—Resumed.

TAXES ON INSURANCE COMPANIES.

The CHAIRMAN. The committee will come to order and Dr. Adams will proceed, beginning where we left off on Saturday.

Dr. ADAMS. Mr. Chairman, we left off at page 93, section 242.

Gentlemen, the scheme in general in section 242 is this: It is to apply a tax on life insurance companies to make it applicable to investment income. Under the present law the premiums paid by a life insurance policyholder are deemed to be actual income by the life insurance company.

Senator MCCUMBER. How is that?

Dr. ADAMS. The ordinary annual premium that you pay on a life insurance policy is the basis of the income of a life insurance company, although no deduction can be made for it by the individual policyholder. It is regarded as a capital transaction to him. He makes no deduction for his life insurance premium payment, but the company when it gets it must regard it as income.

That being a starting point—and I think it is a false starting point—we have to authorize a lot of special and highly unscientific deductions, with the result that the taxation of life insurance companies is one of the faultiest parts of the income tax act. There is a continual litigation over insurance companies' taxes because of the method of taxation.

It has been suggested—and I think it is obviously sound—that the only true basis of income of a life insurance company is its investment income—interest, dividends, and rents which it receives. The premium payments it gets are a good deal like a bank deposit. When it takes them over, it creates an obligation such as the obligation of a bank to return a deposit when it is called for. So that is omitted altogether. You start with the investment income, and certain deductions have been worked out with the result that the life insurance companies will pay very much more taxes under the proposed scheme than they did before.

At the same time, there was on the life insurance companies a special tax of 8 cents on the amount of new business written. That is in Title V. It is one of the special excise taxes. And with the adoption of this new method it was proposed, and the House indorsed the proposal, to wipe out all other taxes on insurance companies; that is to say, this 8 cents on new business and the capital stock tax, which involves special difficulties when applied to mutual insurance companies, and most of them are mutual; they have no true capital stock.

The CHAIRMAN. Doctor, did they have a hearing before the House committee?

Dr. ADAMS. They did not have a hearing, Mr. Chairman. This matter was worked out really so satisfactorily in the revenue act of 1918, when the life insurance com-

panies had gotten together, that they have not appeared before the committees, but have come to me and asked me if we could take this other scheme. I was personally very well satisfied with it, because if you adopt a 15 per cent rate, or if the 15 per cent income tax rate originally proposed had been adopted, we would get more under that 15 per cent tax with the new scheme of taxation than under all the others combined. I am not certain that the 12½ per cent rate will do that. I think it will leave us a little less than we had before. But the scheme would have been infinitely simpler, and we would have avoided this continual litigation.

Senator McCUMBER. Will you repeat again just how you propose to tax them?

Dr. ADAMS. The scheme of taxation starts by defining their gross income as investment income, namely, their incomes from dividends, rents, etc. Then there are recorded against that certain deductions, which I will read.

Senator McCUMBER. And that is satisfactory to both the mutual and the old-line companies?

Dr. ADAMS. All the life insurance companies are behind that scheme and are satisfied with it.

Senator SIMMONS. What do you put on that?

Dr. ADAMS. Ten, 12½, or 15 per cent, whatever it may be; it goes up and down with the income-tax rate. It gives us what we have never had before—a proper, scientific definition of what constitutes the income of a life insurance company.

The CHAIRMAN. How does this differ from the scheme you submitted to the committee in the last bill?

Dr. ADAMS. It is almost the same thing, Mr. Chairman.

The CHAIRMAN. How does it compare as a revenue producer with the present law?

Dr. ADAMS. It will produce about as much revenue as the present law. It will produce more than the present law if you adopt a 15 per cent rate on corporations. If you adopt a 12½ per cent rate it will produce a little less.

Senator SIMMONS. Doctor, I understand you to mean that you treat an insurance company exactly as you would any other corporation. You find out what the income of the insurance company is and then you levy a 12½ per cent tax on that.

Dr. ADAMS. Whatever rate you adopt for corporations generally will apply to them.

The CHAIRMAN. Did we have that amendment in the present revenue law?

Dr. ADAMS. It passed the Senate.

The CHAIRMAN. I know, but it went out in conference. Yes, that is so; it was printed in the bill.

Senator SIMMONS. But it would be subject to no other tax?

Dr. ADAMS. It would be subject to no other tax.

Senator SIMMONS. And not to the capital stock tax?

Dr. ADAMS. No; they would be exempt from that, and if you stop to think of it you will see that the mutual life insurance company has no capital.

The CHAIRMAN. If this proposition has already passed the Senate, I am satisfied with it.

Dr. ADAMS. The present House bill applies to all other insurance companies. I am to have a conference with the representatives of the other insurance companies this afternoon.

Senator McCUMBER. What other insurance companies do you mean?

Dr. ADAMS. Fire insurance companies, casualty insurance companies, and so forth. There are some obvious difficulties in dealing with other insurance companies on this basis. This will suggest the difficulties: A life insurance premium paid by a policyholder of a life insurance company is not a deduction to that policyholder; it is a capital item to him. It is more of the nature of an investment. But it is entirely proper and sound not to terat that as income to a company, particularly when it is a mutual company. However, that situation is entirely reversed in the case of a fire insurance company. A man that pays fire insurance premium treats it as a deduction. He parts company from it in a way in which he does not part company with it in the case of a life insurance company. That is a mere inkling of the differences that exist. And I am not at all certain that this can eventually be maintained for the other companies.

The revenue problem is this: These other companies also have these special taxes imposed upon them under Title V. The tax is 1 per cent upon the premiums of fire, marine, and casualty companies. That has produced a pretty large revenue, yielding fourteen or fifteen million dollars a year. That is now all wiped out. That aspect has to be considered.

Senator SIMMONS. I do not understand that the opposition of the House the last time was so much to the levy as it was to the exemptions, the manner of ascertaining what was the income of the company. Take the mutual companies, Doctor. The mutual company purports to levy only enough to meet expenses and to pay losses.

Now, according to what you stated a little while ago what income would they have to be taxed?

Dr. ADAMS. I think that is a slight mistake, Senator. You are talking about a life company?

Senator SIMMONS. Yes.

Dr. ADAMS. If it is on the participating basis—and the larger companies are—they deliberately levy or collect a premium in excess of the necessary amount, in order that they may have, and very properly have, a margin. That margin is ordinarily returned from year to year in dividends.

Senator SMOOT. Instead of at the end of 20 years when the whole of it under ordinary life insurance would be paid off.

Dr. ADAMS. They get more than necessary in order to to have a margin for emergencies, and then in the ordinary year when they have no emergencies they return it in the form of dividends.

Senator SMOOT. Those margins are not supposed to be very great?

Dr. ADAMS. They are pretty great.

Senator SMOOT. And if you levy a tax upon them that tax would probably absorb a little margin?

Dr. ADAMS. We do not levy a tax upon them, sir. We do not levy a tax on them under the present law.

Senator SMOOT. I am speaking about this proposed plan. What I am trying to find out is whether and what a mutual life insurance company would have to be taxed.

Dr. ADAMS. Suppose we read the act.

Senator SMOOT. They would be taxed on the dividends and rent they receive, just the same as the regular life insurance company, and that is the only way to tax them. This is exactly what we decided upon the last time.

Senator SIMMONS. Yes; but, Senator, I think we ought to have some idea of what that was.

Dr. ADAMS. Section 242, line 6, page 93:

"That when used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contract of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per cent of its total reserve funds."

Senator MCCUMBER. Explain that 50 per cent of its total reserve funds, and why take 50 per cent instead of some other figure?

Dr. ADAMS. Some companies mix with their life business accident and health insurance. It is not practicable for all companies to disassociate those businesses so that we have assumed that if this accident and health business was more than 50 per cent of their business, as measured by their reserves, it could not be treated as a life insurance company. On the other hand, if their accident and health insurance were incidental and represented less than 50 per cent of their business we treated them as a life insurance company.

Senator MCCUMBER. Suppose that you have those companies in which a certain portion of their business is life insurance and other casualty of any kind, and you have two systems of levying taxes?

Dr. ADAMS. You do not under the House bill.

Senator MCCUMBER. How do you levy the tax under the two kinds of business in the hands of one company?

Dr. ADAMS. You do not under the House bill. You did originally under the original suggestion of the Treasury Department, but the House bill now treats them all alike.

Senator DILLINGHAM. In other words, unless a company has a reserve of over 50 per cent on life insurance and annuity contracts it is not a life insurance company?

Dr. ADAMS. No; and it is not very important any more, as you will see. It has only one small application.

Senator MCCUMBER. If they are treated just alike I do not see any necessity of making any distinction.

Dr. ADAMS. They are not treated just alike. There is only one deduction that goes under life insurance alone.

Section 243, line 13, page 93:

"That in lieu of the taxes imposed by sections 230 and 1000 there shall be levied, collected, and paid for the calendar year 1922 and for each taxable year thereafter upon the net income of every insurance company a tax as follows:

"(1) In the case of a domestic insurance company, 12½ per cent of its net income.

"(2) In the case of a foreign insurance company, 12½ per cent of its net income from sources within the United States.

"SEC. 244. (a) That in the case of an insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents.

"(b) The term 'reserve funds required by law' includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

"SEC. 245. (a) That in the case of an insurance company the term 'net income' means the gross income less—

"(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title; (2) an amount equal to the excess, if any, over the deductions specified in paragraph (1) of this subdivision."

This was devised in order not to give them exemption from tax-exempt bonds. The theory of the tax does not justify any real exemption from tax-exempt income. They first take it out in that way and then the other deductions that they would ordinarily get is reduced by that amount.

The CHAIRMAN. Dr. Adams, why were these provisions not put in the bill as it passed the House?

Dr. ADAMS. They are in the bill as it passed the House, Mr. Chairman.

The CHAIRMAN. Yes; that is true. I misunderstood your statement.

Dr. ADAMS [reading]:

"(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per cent of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the commissioner finds to be necessary for the protection of the holders of such policies only."

Senator CALDER. Will you read that again?

Dr. ADAMS. Let me explain that. There are developing at the present time, and have been for a few years past, companies which insure combined accident, health, and life insurance policies. There is no proper actuarial basis for it. Consequently, there are no laws stipulating what reserve shall be held against it. It is particularly necessary that there should be large reserves for it. It is a particularly dangerous form of policy for the companies and specially high reserves have to be held. Now, in all insurance in the past we have exempted only the reserves required by law. But here is a small class of companies which under a moral and real compulsion retain specially high reserves, but the law does not require any. Consequently, they come in and say, "We want a special reserve for this purpose; we are sure that you will acquiesce." They say this to the department and to the Congress:

"In the necessity for these reserves we are perfectly willing to let you fix them, only we want some deduction." That is the essence of their statement.

Senator CURTIS. It authorizes the Secretary to fix the reserve if it is not fixed by law.

Dr. ADAMS. Yes. For a very small group of companies.

Senator MCCUMBER. I can not imagine anything more abstract and unmeaning to the average intellect in reading that paragraph the way it is written. I know very well if I understood the facts and methods that I could write something that would be clearer than that abstract proposition in order to indicate what I was getting at, even though I had to take twice as many words with which to do it.

Dr. ADAMS. Well, it so happens that this——

Senator MCCUMBER. It may be clear to you who have the whole thing in mind and with the half thousand exceptions and limiting conditions to understand what it means, but to the average person reading that paragraph—and I do not care if he is a mighty good lawyer—unless he understands thoroughly what it applies to, he would not understand what it meant.

Senator DILLINGHAM. I understand Dr. Adams says there are laws in every State of the Union regulating reserves and straight insurance companies.

Dr. ADAMS. There are laws in every State of the Union fixing them absolutely.

Senator DILLINGHAM. But now with the new form of policy covering accidents and health the States have not adopted statutes saying what the reserve shall be in those cases.

Dr. ADAMS. They have not because they do not know what they will be.

Senator CURTIS. And there are new companies that have sprung up within the last few years. They have now reached the point where they will give you an accident policy and let it cover your wife for six months.

Senator SMOOT. Why do you put in life here, etc.?

Dr. ADAMS. This, by the way, is not suggested by the companies themselves. There are, I suppose, 10 companies in the United States interested. There are not over 10 taxpayers who need to read this: "In case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy on the weekly premium payment plan." While I am not absolutely certain of it, I think it is in the present law in much the same language.

Senator MCCUMBER. Doctor, let us go over this again:

"SEC. 245. (a) That in the case of an insurance company the term 'net income' means the gross income less"—

Now, these are nets to be subtracted from our gross income. What is it?

"(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title."

I am not complaining of this simply because you have to go back and study those. It seems to me it would have been just as well to state the amount of interest received during the taxable year, and then state what that interest is, instead of referring back to something else. What is the use of referring to something else? You have to turn over to that section, and when you get to that it refers to something else, instead of saying just what you want to say in that paragraph so that when a person reads it he will know what is meant.

But the second one is what gets me. Now, let us see how clear that is:

"(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision"—

Which you have to go back again and see—

"Of 4 per cent of the mean of the reserve funds required by law."

You have to find out what the law requires.

"And held at the beginning and end of the taxable year"—

And now we have to add something—

"Plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly payment plan, continuing for life and not subject to cancellation) 4 per cent of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the commissioner finds to be necessary for the protection of the holders of such policies only."

If there is any man sitting at this table who understands what that is other than Dr. Adams, I would like to have him speak.

Senator SMOOT. Could not this be written direct rather than the reverse policy of paragraph 1? The first is a reduction and then the next is a plus. Can we not put it in some way so it will be direct and not indirect, as this is?

Dr. ADAMS. Now you are dealing with substantive. Just start out with subdivision 1. Now, let us see some of the technical difficulties. In subdivision 1 you give a deduction of tax-exempt interest.

Senator SIMMONS. If we have complied with the law and given according to the law, why should we take it away?

Dr. ADAMS. I will explain that. Under subdivision 2, by indirection, you give them the same deduction again. That is the main body of the deduction. If you take 4 per cent of the reserves required by law, which includes their tax-exempt bonds which will be earning about 4 per cent a year, perhaps, then you ought to deduct that tax-exempt income from that, because you will be giving it to them twice, and the companies acquiesced in it. Consequently, you have to deduct it. It would not be lawful unless that were taken out. Secondly, you give the ordinary company the 4 per cent of the mean or the average. That mean is the technical proper term, and nobody but a small number of life insurance companies are interested here. Only experts are interested. You give them first of all 4 per cent of the mean and nothing else will do. The only word you could possibly substitute would be the word "average."

"Held at the beginning and end of the taxable year." In the case of certain insurance companies that language merely repeats the language of the present law, language which the companies themselves proposed and which they understand, and there are only 10 or a dozen companies in the United States that are interested in this.

The ordinary taxpayer does not have to follow it through. The language in your present law gives deductions "in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the

weekly premium payment plan." In addition to the above, such portion of the net addition not required by law made within the taxable year, as the commissioner finds to be necessary for the protection of the policyholders of such policies only.

Senator McCUMBER. I am much obliged, Doctor. I understand it almost as well as I did before you made your explanation. But I assume somebody will understand it. I confess that I do not.

Dr. ADAMS. Before you finish with this you will have before you Mr. Beaman. Mr. Beaman is a real expert.

Senator SMOOT. I can understand exactly what you mean here, and it will work out, but I think it could be expressed so much better by having a direct statement rather than an indirect statement.

Senator McCUMBER. Even though we use twice as many words.

Dr. ADAMS. We will do that. I am glad to hear you say that in some respects you would prefer to take twice as many words.

The CHAIRMAN. I think the policy all through this bill of too many words rather than too few is better. This business of referring to section 200, subdivision (b) and scattering your brains all through the bill looking up one paragraph after another we find very confusing.

Dr. ADAMS. Suppose you had to cite half a page there. It depends upon how long a section you refer to. If it is short you can put it in.

The CHAIRMAN. Of course, you have to use some latitude of expression, but do not try to make it mathematically exact

Dr. ADAMS. I am glad to have that advice, and I shall be glad to do as you and Senator McCumber wish.

The CHAIRMAN. I know that you are so saturated with the thing that what seems plain to you is still obscure to us. In the last bill there was nothing that we had more contention over than this insurance provision, owing to the peculiar attitude of Mr. Kitchin, and probably every insurance man in the United States of any prominence was down here to see members of the committee. It has been different this year. Not one has been to see me; so it must be satisfactory to them.

Dr. ADAMS. Senator, I shall follow and shall be only too glad to follow the suggestions made.

Senator SIMMONS. You say this is probably what we had in the Senate bill before and they come down here and had long conferences with Dr. Adams and others and they agreed to that. Now, after it has been put in by the House, as the House was the stumbling block before, I take it that they think it will meet with no trouble in the Senate because we passed it once.

Senator McLEAN. Dr. Adams's statement will be printed and you can all read that.

Senator SMOOT. All I want to do is to put it just the opposite way around and go right to the subject matter direct.

Senator McLEAN. I think I understand it as the doctor reads it, but, of course, it is a very involved sentence, and unless one studies it carefully he would find difficulty in interpreting it.

Senator SIMMONS. Senator McLean, you live in a portion of the country where they have large insurance companies and you understand their methods. There are many of us that do not know anything about the methods of the insurance companies, and a good deal of this phraseology is new to us; it is to me, at least. But if in an involved case like that Dr. Adams would just write down in plain parlance what it means and hand us that, I think it would be very helpful to us.

The CHAIRMAN. I understand that the doctor is going to do that. I certainly have the impression that in all these things he is offering each member of the committee a memorandum to use in debate on the floor of the Senate.

Senator McCUMBER. Well, we could puzzle anybody on that thing.

The CHAIRMAN. If you could, Dr. Adams, popularize your phraseology a little so it will be like reading on a railroad train, it would be helpful.

Dr. ADAMS. Mr. Chairman, I am only too glad to have you tell me that. I have not followed my own impulses. I have followed the official style of the department, largely fixed by Mr. Beaman.

Let me point out some of the difficulties of the department. Take this first reference under section 1, "The amount of interest received during the taxable year which, under paragraph (4) of subdivision (b) of section 213, is exempt from taxation under this title."

The CHAIRMAN. I would not think for a moment that you ought to quote that paragraph.

Senator McCUMBER. That part we can turn back to, but take the next one.

Dr. ADAMS. The next one I will split up and try to make plainer.

The CHAIRMAN. Doctor, your language is classic and quite capable of statutory phraseology. I am not saying that in any over commendation, because I know that

Mr. Beaman and others have helped, but, at the same time you can carry anything a little too far.

Dr. ADAMS. All right, sir, we will try to shape it so as to avoid those difficulties.

"(3) The amount of dividends included in the gross income.

"(4) In the case of life insurance companies, an amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract."

That is to take care of new companies, one of which Senator Dillingham specially knows about, the National of Vermont.

Senator DILLINGHAM. Deferred dividends?

Dr. ADAMS. Yes; they are reserves not required by law, and a special deduction of 2 per cent has been given on those.

Senator CURTIS. It would be a good idea if you made this a little larger. In our State we had one company that had reserve dividends that got into the courts, and that company went into the hands of a receiver.

Dr. ADAMS. They are not permitted to reserve dividends any more in this way.

Senator CURTIS. That is a good idea.

Senator SIMMONS. Doctor, take the word "dividends" in subdivision (3). What is the technical meaning of the word "dividends" in that case? It says "The amount of dividends included in the gross income."

Senator MCCUMBER. That means dividends received from outside, or some other corporation.

Dr. ADAMS. Yes. This word "dividends" as mentioned in subdivision (3) means dividends on ordinary stock in another corporation. "Dividends" as used in subdivision (4) is used in the popular life insurance sense of dividend. This is specially taken care of in the definitions.

Senator SIMMONS. Why could you not say "Dividends received from bther corporations?"

Dr. ADAMS. Section 201 defines dividends with great care.

Senator MCCUMBER. Now, let us see. These are things to be deducted from the gross income. You are to deduct under subdivision 3 the amount of dividends included in the gross income.

Dr. ADAMS. Put it in and take it out.

Senator SMOOT. The way you have to do it now.

Dr. ADAMS. Yes.

Senator MCCUMBER. When I first read it it struck me as dividends which they paid out, because it does not say dividends received. Suppose you had said the amount of dividends received and included in the gross income. I would have known in a minute then what it meant.

Senator SMOOT. It could not be included in the gross income unless it was received.

Senator MCCUMBER. But there is nothing there to indicate that they are not their own dividend that you are talking about. You would have to study it carefully to find out what it was. Why not state it as clearly as an individual would and say the amount of dividends received?

Senator DILLINGHAM. But this whole thing relates to the income of the company.

Senator MCCUMBER. I know, but it is a deduction. I want to know whether they are dividends paid out or received if they are to be deducted.

Dr. ADAMS. We will put in "received and included in the gross income."

In subdivision (4) the word "dividends" is used in an entirely different sense, and that is stipulated in the beginning in your definition. These are dividends that the insurance companies pay.

In subdivision (4) this is special deduction for the so-called deferred dividend reserve, which is a nonlegal reserve. It represents a moral rather than a legal obligation. This subdivision is a special deduction of 2 per cent on the reserves for these dividends, the payment of which is deferred for a period of not less than five years from the date of the policy contract.

"(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year."

The purpose of that paragraph is this: Some companies very rigorously and exactly allocate or set aside their investment expenses. Some other companies do not do so, and by the provisions of the existing law in most States where they do not do so they are limited by an arbitrary deduction, which, however, is quite accurate, of one-

fourth of 1 per cent of the book value of the mean of the invested assets held at the beginning and end of the taxable year. That provision is adopted here.

Senator SMOOT. It is best to keep away from those averages if you can, because they will bring up all sorts of questions in the settlement of the return.

Dr. ADAMS. That one particular average, Senator, is used and has been used for years for the purpose of reporting to the State departments. It is a check imposed upon them now by law. They are quite habituated to it, and the practice has shown that it apparently is also quite accurate. If they can allocate and say absolutely just what their investment expenses have been, they are permitted to take them. If they do not go to that trouble, they are not permitted to take more than one-fourth of 1 per cent of the book value of the mean of the invested assets. That, again, was a part of the Senate bill that was adopted before and is at the suggestion of the companies themselves.

"(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property."

Senator MCCUMBER. That is just on real estate?

Dr. ADAMS. Yes.

Senator MCCUMBER. I suppose the other tax is taken care of in a subdivision?

Dr. ADAMS. No; the other taxes they do not take. The only taxes they deduct are those connected with their investment income. Taxes based upon collection of premiums are not allowed as deductions.

Senator MCCUMBER. Why?

Dr. ADAMS. Because we are taxing only the investment end of their business.

Senator MCCUMBER. But suppose they paid taxes to the States, etc., on other property than real estate. Suppose the State taxes them?

Senator SMOOT. An income tax, you mean?

Senator MCCUMBER. Yes; income or any other kind of a tax. Outside of real estate, why should not they deduct it?

Dr. ADAMS. The theory upon which this is based is the proposition that the larger part of their business is practically equivalent to taking deposits by a bank, and, consequently, that end of their business does not give rise to a taxable income. We attempted to segregate their tax. Taxes that go along with their investment business are properly deductible. The taxes that may be set over against premium income are not deductible. I think the whole theory does not justify their deduction. It would mean too much.

Senator MCCUMBER. But here you allow them to deduct only real estate tax.

Dr. ADAMS. They have no taxes that are largely connected with the investment end of their business. They do not pay property tax on the value of their bonds. There are no taxes of that kind on an insurance company.

Senator SIMMONS. You mean that the State does not tax them?

Dr. ADAMS. Not on that basis.

Senator MCCUMBER. Suppose the State were to tax them for doing business, and it is a part of their expenses. What is the difference whether they pay $100,000 on their real estate or $100,000 tax to the several States for the right to do business in the several States?

Dr. ADAMS. We are not taxing or touching their premium income. The hundreds of millions of dollars which they collect as premiums we are not looking at. The collection of those premiums constitutes their main business which they are doing among themselves, and so far as their expenses go to that nontaxable end of their business those expenses we are not concerned with.

Every State insurance law, for instance, sets aside a certain amount of each premium collected as expenditures for collecting it. The agents' commissions, taxes imposed by the State on premiums, belong to that nontaxable end of their business. We do not tax the receipt of the premium income. Consequently, we ought not to permit deduction of the expenses that go along with that. On the other hand, they are great investment agencies investing money. That interest which comes in ought to be taxed. The expenses which may clearly be assigned to that end of the business should be deducted

Senator SMOOT. We impose only 12½ per cent on the invested net income.

Dr. ADAMS. Yes.

Senator SMOOT. Of course, these taxes would all come out of that.

Dr. ADAMS. That may be paid out of premiums.

Senator SMOOT. Well, it does not matter how it is paid.

Senator SIMMONS. These deductions here are made for the purpose of ascertaining the net income that we are going to fix, are they not?

Dr. ADAMS. Yes.

Senator SIMMONS. So I do not see the force of what you state.

Senator SMOOT. If these deductions are not allowed here, then they would have to pay on the investment incomes, provided on page 3 of the bill, which would be a double taxation.

Senator SIMMONS. As I understand you now, Doctor, what you are saying is that we do not tax premiums in any way?

Dr. ADAMS. No.

Senator SIMMONS. In their premiums they levy a sufficient fund to pay all taxes that they may be subjected to by the State.

Dr. ADAMS. And other expenses as well.

Senator SIMMONS. And other expenses in addition?

Dr. ADAMS. Yes.

Senator SIMMONS. So we are not depriving them of anything.

Dr. ADAMS. No.

Senator SIMMONS. Because we do not tax that.

Dr. ADAMS. We do not tax it. You see the actuary laws on which these legal reserves are based assume that so much premium collected is to pay for mortality expenses and so much for general expenses, clerks, commissioners' fees, taxes, and other things. As we are ignoring premium receipts, we necessarily ignore reductions which go along with these premium receipts, and which we would allow if we used premium receipts as gross income. We allow them now under existing law. We set all that thing aside and confine ourselves merely to the interest and rent which they receive and the deductions which go along with that end.

Senator DILLINGHAM. You tax them on their income?

Dr. ADAMS. Yes; on their true income.

Senator SIMMONS. If they have the amount of these premiums that they charge, why do they not also include in that provision the taxes on the real estate?

Dr. ADAMS. The income accounts of insurance companies very carefully differentiate, and have done so for years, their investment income. That is a feature of insurance accounting. They make a report every year to the State insurance department in which their investment income is separated from their premium income.

Senator SIMMONS. And they do not provide for that in these premiums?

Dr. ADAMS. That is a natural charge against their investment incomes first. You see your essential problem is to split up their business into two parts, one taxable and one nontaxable, and the expenses must also be split up.

Senator SIMMONS. I see, if that is the way they keep their books, and I assume they are right about it.

Dr. ADAMS. "(7) A reasonable allowance for the exhaustion, wear and tear on property, including a reasonable allowance for obsolescence."

"(8). All interest paid within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from taxation under this title as income to the taxpayer."

Senator SIMMONS. "Indebtedness" is a pretty broad term there, unless you have defined it somewhere.

Dr. ADAMS. That is a deduction given for interest of other taxpayers, Senator, almost exactly, and it is very important, because life insurance companies do not ordinarily borrow money.

Senator SIMMONS. You would not call their losses indebtedness?

Dr. ADAMS. No. This was not in the act as it passed the Senate the last time, because life insurance companies so seldom borrow money, but they had got to borrowing money during the war to buy Liberty bonds, and now some of them have actually borrowed money to carry Liberty bonds, and we gave them a deduction for the interest.

The CHAIRMAN. Doctor, is not the allowance for obsolescence rather unusual?

Dr. ADAMS. That is checked immediately below. It would be unusual except for this purpose: Where property is held as a part of the investment of the company, and they are obviously entitled to a deduction for the obsolescence depreciation against that part of the property. Obsolescence is not special to insurance companies. We mention it in connection with depreciation allowance to other taxpayers. That is exactly the same verbiage as applies to other taxpayers.

The CHAIRMAN. It refers to property held by the insurance companies?

Dr. ADAMS. Yes; and for investment. You will see that this is limited and circumscribed in the section that I am about to read:

"(b) No deductions shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by an insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned or occupied."

Now, the thought there is this: Insurance companies very frequently invest a large portion of their funds in a building which they themselves occupy. That is an investment of a peculiar kind. It yields no income except as it saves them the rental expenditure. Where that is true, the companies acquiesce in this provision that they shall not have deduction for real estate taxes, or that they shall not have deduction for depreciation unless they put the estimated investment income from that building back into their income. You see that it is a sort of a silent income. It is income only by saving them what they would have to spend if they did not put their money in that building.

Senator SIMMONS. That is where they use the building only for the purpose of carrying on another business than insurance?

Dr. ADAMS. Yes.

Senator SIMMONS. But where they rent and use a part of that building——

Dr. ADAMS. That is taken care of in this provision, because it says that you have to actually get in income 4 per cent of the capital invested in that building, and unless you have that much you can not take a deduction for taxes or a deduction for depreciation, but if you have that much you may take those deductions. And you may also take those deductions in case of real estate which you own and rent to other people.

Senator MCCUMBER. Now, tell me, Doctor, why the necessity for all that complexity? Why could not you compel the company to make a return for all income received, whether it was an investment in a building or otherwise, and then allow them to deduct their taxes on that building, which gives them a net of what they received on the building? What is the use of that 4 per cent and an addition? They have invested.

Dr. ADAMS. They may occupy, as I know one insurance company does, all the floors except the first and second and third. They occupy 11 floors. They may rent part or the whole. In getting at their occupancy, a large part of which is estimated rental value, there would be innumerable difficulties, which we would dispute and haggle about. Estimated rental value is very difficult to get at.

Senator MCCUMBER. What is the use of charging them off rent they do not pay? As long as they have their capital invested in so many floors, and they are occupying them, they do not have to pay that sum out, and consequently they receive that much more. Their gross income would be that much more, and their net income would be that much more, and you tax their net income. What is the use of dividing that into a 4 per cent proposition and having all these complexities?

Dr. ADAMS. I was trying to explain that. Your solution of it was the solution that I suggested originally. It is the result of long conferences and a lot of thought and care. I said to these gentlemen, "Why take your deductions for taxes on real estate which you occupy? Why put in your income from real estate which you occupy, your estimated income?" They convinced me that it would be more satisfactory to do it that way—more accurate. After our investigation I was satisfied of the correctness of their views, in the case of some of these enormous New York buildings, like the Metropolitan Building, Twenty-third and Broadway, New York.

The CHAIRMAN. Any of those large buildings.

Dr. ADAMS. The thing does not check out. It is more accurate to go through the roundabout process of allowing them the depreciation and deduction. This estimate of rental value is a terrifically difficult thing. It is difficult for us; it is difficult for anybody to estimate what the rental value of a building is, where it is not actually rented to somebody else. In order to cover that situation, it is necessary to say that unless they are actually renting to somebody and by contract getting the money, we will put in a limitation, and assume thay are receiving at least a certain amount net for it.

Every word of the phraseology of that section has been gone over by insurance experts of the very highest caliber. Only a few people are involved. The public is not interested in this. They do not have to read it, and the people who deal with it are experts. Every word of that phraseology was presented to the insurance officials, and only those companies who are involved must understand it. Of course, you gentlemen must understand it, as long as you have to pass upon and approve it. You people have an understanding that the outside public does not have to have.

Senator McCUMBER. But suppose a company is organized to do a mercantile business, puts up its own building, invests so much of its own capital, and it occupies a certain number of stories in that building and rents the others. If they invest capital in a place to live in, a place to do business in, they do not have to pay rent. They save that much. You compel them to make a return of what they receive for rent of a certain portion of that building?

Dr. ADAMS. Yes.

Senator McCUMBER. Just the same as any other line of business. Why should that not apply equally to insurance companies?

Dr. ADAMS. The reason for that is that you have a situation with insurance companies which does not apply to any other companies. A great part of their business is nontaxable. They put up a building costing fifteen or twenty million dollars. Nineteen-twentieths of it may be used for the transaction of the nontaxable part of their business. There is where that difficulty has arisen. Nineteen-twentieths of it may be used for the purpose of collecting premiums and paying losses, to which we are now paying no attention. That is the nontaxable end of their business. Perhaps only one-half of one floor is given to the investment business, which is the taxable end of their business.

They would come along and say they had a certain depreciation deduction on certain taxes they paid. We would have to go through some kind of prorating process to say how much depreciation there should be and how it would be taxable, as assigned to the taxable or investment end of their business. To avoid that this plan is used. You can not base deduction on all the taxes; you can not base depreciation on all the taxes without some limitation, because we must get some generally just and equitable method of prorating those deductions.

Senator SIMMONS. I do not know that I understand this question, and I will state to you my understanding of it, and ask you if I am correct.

This means they shall not be entitled to the deductions provided in paragraphs 6 and 7 where they occupy a part of the building, unless they include in their gross income return the value of the space so occupied. Now, in order to fix the value of that space, you take the rents they receive from other tenants, and you add to that a sum which will make an annual return for that property of 4 per cent.

Dr. ADAMS. Four per cent. There is another purpose there that is very essential, and that is this: You are giving these companies a deduction of 4 per cent on their reserve fund. Their reserve funds are invested in this building. You are giving them a deduction of 4 per cent once, through the 4 per cent reduction against reserve funds. You do not want to give them that again. You take the rent which they get and deduct the depreciation from it, and the remainder should not be less than 4 per cent upon the capital invested.

Senator SMOOT. Suppose it is more than 4 per cent?

Dr. ADAMS. All right; if it is more than 4 per cent, we are willing to do it, but it will not be less than that, because they have already had that deduction.

Senator SMOOT. If it is more, we would want the difference over and above it.

Senator SIMMONS. Four per cent is a very small return upon real estate.

Senator SMOOT. I do not think so.

Senator SIMMONS. You do not?

Senator SMOOT. I do not think there is any real estate in the United States, with all expenses and depreciation paid, which will net 4 per cent.

The CHAIRMAN. I do not believe it does in Pennsylvania.

Dr. ADAMS. The next is subdivision (c).

The CHAIRMAN. I am not going to be contentious about this, and I recognize the highly technical character of these paragraphs, but I will confess they seem to me to be worded in a very involved way that is utterly unnecessary. I may be wrong.

Senator SMOOT. We would have to have a good many different employees to check these things up?

The CHAIRMAN. Yes.

Senator SMOOT. Whenever it is a question of what is 4 per cent, it has to be investigated, and that will take men all over the country.

Senator SIMMONS. Take this section, and it is going to provide for the thing that no doubt the doctor is trying to provide for; I do not see how you could express that much more plainly.

The CHAIRMAN. That may be, but it provides in subdivision 7 for a reasonable allowance for obsolescence, leaving the reader utterly at sea as to what kind of obsolescence is meant. It does not say "obsolescence as hereinafter defined." Should there not at least be a reasonable allowance for obsolescence as hereinafter defined?

Dr. ADAMS. I do not think there is any reason why that language should have been in the law. The language you have just read is the language of the ordinary depreciation deduction, the regular taxpayers' deduction.

Senator McCUMBER. We can understand that.

Dr. ADAMS. It went into the law that way, and came back as "deductions for exhaustion, wear and tear, with a reasonable allowance for obsolescence."

Senator McCUMBER. If a thing in a building becomes obsolescent, of course, it includes any depreciation.

Dr. ADAMS. The word "depreciation" was the word to use.

Senator McCUMBER. "Depreciation" covers it. You have "exhaustion, wear and tear."

Senator SMOOT. That is depreciation.

Senator McCUMBER. I know, but a thing may become depreciated by reason of some part of it becoming useless, and that is not included in your definition.

Senator REED. "Obsolescence," if I understand the term, is generally applied to a case like this: Let us say that the dynamo in this building is of an inferior kind. A new one is invented. It therefore becomes necessary to throw the old machine away and to install the new one. Or, even if the particular machine is worn out and fairly worthless, I think it covers that.

"Wear and tear" is a different thing. The roof on this building is suffering from wear and tear. I agree with Senator Penrose that the term "obsolescence" is a very questionable one to use.

Senator McCUMBER. If any fixture or part of the building is no longer of use, it would be included in the depreciation.

Senator REED. I think "depreciation" would cover it.

Senator SMOOT. I think it would not cover it in every case, Senator Reed. For instance, take a case like this, this very machine you speak of here: It may not have been worn out, but too expensive to maintain.

Senator REED. Yes.

Senator SMOOT. And you would put in a new system that had been discovered. Of course, the old machine becomes obsolescent.

Senator REED. May I interrupt long enough to ask a question, and sort of catch up with what is going on? I just came in a short time ago.

I heard you discussing the question of a 4 per cent return on real estate. What is the return this bill allows on money.

The CHAIRMAN. That question of the return on real estate was incidentally touched upon.

Senator REED. What is the return allowed on money?

Dr. ADAMS. There is no specified rate.

Senator McCUMBER. We were discussing the question of insurance companies occupying part of their own buildings.

The CHAIRMAN. I would like to ask you, Senator Reed, in St. Louis, or any of the large cities in your State, what would be considered a fair return on an office building, on the investment?

Senator REED. I think about 5½ per cent.

The CHAIRMAN. Do they actually get that, do you think?

Senator REED. Do they get it now? Yes; I think they do.

The CHAIRMAN. I mean net.

Senator REED. I think they do now. I think there was a period when they did not.

You see, if you get the return on real estate too low, manifestly, people will not try to build buildings.

The CHAIRMAN. There seems to be a class of people, largely millionaires, who are continually raising rents and crying poverty around Pennsylvania. I do not know how it has been elsewhere.

Senator REED. The fact about the matter is that if you make real estate too nonproductive, you accomplish the very thing you sought to avoid. You accomplish high rents. If real estate was overproductive for a period of time there would be so many houses built that there would not be people to live in them. When you make it nonproductive they quit building.

But this is aside from the business of the committee.

The CHAIRMAN. We have pretty nearly finished with insurance companies, and we will go on to the administrative sections of the bill.

Dr. ADAMS. I may say, in general, if you gentlemen want to repeat your action in the previous law, and define depreciation deduction in those words, I should think it a very wise action.

Senator SIMMONS. While I think "obsolescence" is a good term to use in reference to equipment and machinery, when we are dealing only with real estate and buildings, as we are in this case, it seems to me the word is out of place.

Dr. ADAMS. The word "obsolescence"?

Senator SIMMONS. Yes.

Senator MCLEAN. Might you not have something that has appreciated in value and yet be obsolescent?

Senator SIMMONS. A building?

Senator MCLEAN. Some part of the building, something attached to the building, might be worth more than when it was put in there, and yet it would be obsolescent, but would not be depreciated.

Senator SIMMONS. An office building would be about the only kind of a building an insurance company would erect, a building with certain space to be allocated to themselves and the balance to be rented out. They are furnished largly by the tenants. They have heat and things of that sort.

Senator MCLEAN. Take it on a rising market, with an engine, or something of that sort, that is put in before the war at a low cost, and it might be worth twice as much as it was.

Senator SMOOT. If they put a new one in, they would have to pay for it.

Senator MCLEAN. It would not be depreciated, but might be obsolescent, as far as being in use by that company is concerned. I do not know that any such thing will occur, but it seems to me that it would be possible.

The CHAIRMAN. Think over that matter, Dr. Adams.

Senator REED. I want to make a suggestion about this clause. I do not think it is right to use the term in any respect. I think the question of the value is the thing to be determined. Senator McLean's illustration is true. Property may double in value, and yet be obsolescent, in spite of the fact that it had doubled or trebled or quadrupled in value. Why should we not say that they should have to pay on the fair value of the property and stop at that?

Senator SMOOT. We are taxing only their net income, Senator Reed, in this insurance matter, and it would make no difference.

Senator REED. If you are taxing the net income, and then allowing them to subtract from the net income the wear and tear upon the property, you will not have much left.

Dr. ADAMS. Subtract from the gross income.

Senator REED. And not include in it the rise in the value of the property.

Senator SMOOT. The gross investment income, I should have said.

Senator REED. If you do not include the value, you will be left in the lurch.

The CHAIRMAN. This provision, Senator Reed, was substantially passed by the Senate by unanimous vote when the present revenue law came up, and it failed in conference. It now comes up again.

We will go on, Dr. Adams.

Dr. ADAMS. Subdivision (c), line 19, page 96, reading as follows:

"(c) In the case of a foreign insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States, is of the reserve funds held by it at the end of the taxable year upon all business transacted."

Senator SMOOT. If the business is not profitable in the foreign countries and it is in this country, you take the average of the business?

Dr. ADAMS. We compute the income of the business as a whole and then prorate on the reserve fund without the United States.

Senator SMOOT. I see.

Dr. ADAMS (reading):

"SEC. 246. That every insurance company not exempt under the provisions of section 231 shall make a return for the purposes of this act. Such returns shall be made, and the taxes imposed by section 243 shall be paid, at the same times and places, in the same manner, and subject to the same conditions and penalties as provided in the case of returns and payment of income tax by other corporations, and all the provisions of this title not inapplicable, including penalties, are hereby made applicable to the assessment and collection of the taxes imposed by section 243."

There is no change in the administrative provisions until we get down to page 99, beginning at line 5.

Senator REED. Doctor, you are passing them without reading them. Let me ask one question. Do these parts we are passing over provide for the assessment of penalties, or leave it optional with the collector of taxes?

Dr. ADAMS. I do not recall any optional penalties. It would be rather strange if they were there. We are pretty rigid on those provisions.

Senator REED. When we get to the question of penalties I want to ask the committee to give that special consideration.

Senator CURTIS. You had better make a note of that, Doctor.

Dr. ADAMS. You are right at it now. This is the section that deals with it. If you want to understand that idea I will read the whole business. It is one of the most highly difficult points in the income tax. You must read the old law, that has not been changed, as well as the new. Suppose I read it all, starting at page 97, line 15, starting out with respect to the payment of taxes. The first paragraph, down to line 14, page 98, provides for installment payments.

The CHAIRMAN. That is the present law?

Dr. ADAMS. The present law, providing for payment by installments. I will read it.

"SEC. 250. (a) That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted the time for payment of the first installment shall be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments shall not be postponed unless the commissioner so provides in granting the extension. In any case in which the time for the payment of any installment is at the request of the taxpayer thus postponed, there shall be added as part of such installment interest thereon at the rate of one-half of 1 per centum per month from the time it would have been due if no extension had been granted, until paid. If any installment is not paid when due, the whole amount of the tax unpaid shall become due and payable upon notice and demand by the collector.

"The tax may at the option of the taxpayer be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension."

Senator REED. Why should we not let a man pay all his taxes on or before the time fixed by law?

Dr. ADAMS. That is his option.

Senator REED. If he did not pay it at the exact time of the return, why should he not be permitted to pay it at the time the first installment is due, and pay it all at that time?

Dr. ADAMS. That is what it says, "on or before." Occasionally a man wants to pay it all off, to go to Europe, or something of that kind.

Senator REED. You do not understand me or I have not made myself plain. "Paid on or before the time fixed by law for filing the return."

Dr. ADAMS. That is the first installment.

Senator REED. Yes. Why should he not be permitted to pay the balance of his installments at that time?

Senator CURTIS. He may if he wants to, Senator.

Senator REED. No; they must be paid on or before the filing of the return.

Dr. ADAMS. As a matter of fact, we accept what you have suggested. It is not mentioned in the law, but we accept it if a man wants to do it. If he wants to make it in a single payment, obviously, as a matter of verbal logic, he must make it before or at the time of his first installment payment.

Senator SIMMONS. But, suppose he has paid his first installment, and when he goes to pay his second installment, he says he wants to pay the third and fourth installments also?

Dr. ADAMS. We will take it and give him a receipt for it and be glad to do it, although the law does not mention it.

Senator REED. I think the law prohibits it. The law reads:

"The tax may, at the option of the taxpayer, be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension."

Senator MCLEAN. He can not pay it in a single payment unless he pays it at or before the time of the first payment.

Senator REED. That is true. The point raised by Senator Simmons is——

Senator MCCUMBER (interposing). Turn to the next page, line 14.

The CHAIRMAN. Dr. Adams says they take the money.

Senator MCCUMBER. It says: "The tax may, at the option of the taxpayer, be paid in a single payment."

Senator REED. That is where I am reading. Why should not the law contain the clause "or the balance due may be paid at any time?"

Senator SMOOT. At any time thereafter.

Dr. ADAMS. It will not do any harm. We will put that in, if you like.

Senator MCCUMBER. If he has paid one installment, he can pay the other three at one time.

Senator REED. By reading the law he can find out what he can do.

The CHAIRMAN. Go on, Doctor.

Dr. ADAMS (reading):

"(b) As soon as practicable after the return is filed the commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments.

Senator MCLEAN. Does that provide for paying the whole if he wants to?

Dr. ADAMS. No; that provides for payment after the first installment. If he pays too much, it will be credited to him.

The CHAIRMAN. The principal thing in that is to expedite the refunding, which is quite a long time proposition.

Dr. ADAMS. That will come later.

The CHAIRMAN. How long does it take for the average amount to be refunded, Doctor?

Dr. ADAMS. Some time.

The CHAIRMAN. Several years, does it not?

Dr. ADAMS. As a rule.

The CHAIRMAN. Then I hope Dr. Adams will make another memorandum, to put some provision in this bill to expedite the refunding of undisputed claims.

Senator REED. A man just left my office who has paid the collector $500,000 too much, and he has the document from the Government admitting the fact, away along last March or June. He can not get his money, and he is having a terrible time.

The CHAIRMAN. It is one of the crying evils of our system.

Senator MCCUMBER. Why can we not put a requirement in there on the part of the Government to pay the same rate of interest on money due the taxpayer that is not returned to him that the taxpayer has to pay upon the amount due the Government if there is a delay in making a payment?

Senator REED. That would only partly meet the case. In this particular case, this man had a contract with the Government and also a contract with the British Government. They collected $500,000 too much. The payment of that tax involved a settlement with the British Government, and he can not get a settlement with the British Government until he gets that money. There are other such technicalities of that kind which the payment of interest would not relieve.

The CHAIRMAN. Not entirely, not but a small percentage in many cases.

Dr. ADAMS. It is a difficult matter, gentlemen, to collect a claim of $500,000 against the Government, and it requires a lot of work.

Senator REED. This has been through all the hearings and had an adjudication.

Dr. ADAMS. It may be held up by the comptroller.

Senator REED. I was just going to call you up and ask you if you could not put a red tag on it and get it through.

Dr. ADAMS. The delay works a great hardship, but it can not be cured by any ordinary process of law, in my opinion. You have got somehow to get a class of people in the Treasury Department who can be trusted safely to pass on claims of $500,000, and keep them there. I had a man in my office yesterday about a claim for $3,000,000. It may be sound and right, but it is a pretty solemn affair to pass upon and eventually pay a claim for $3,000,000 against the Government, and unless the Comptroller or the Secretary of the Treasury feel that men of that caliber are around them, there is an endless amount of red tape connected with it.

The CHAIRMAN. See if you can not put something in the law that will at least show that we are alive to the situation and would like to relieve it.

Dr. ADAMS. We have endeavored to do that, as you will see later, Senator.

The CHAIRMAN. All right.

Dr. ADAMS. It goes on and says, beginning in line 2, page 99:

"And if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252."

Line 5:

"If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits due to the taxpayer under section 252 be paid upon notice and demand by the collector."

Mr. WALKER. There is an error there and we have a correction slip to be substituted for lines 5 to 12.

Dr. ADAMS. I will read the correction, then, for lines 5 to 12, page 99:

"If the amount already paid is less than that which should have been paid, the difference, to the extent not covered by any credits due to the taxpayer under section 252 (hereinafter called 'deficiency'), together with interest thereon at the rate of one-half of 1 per centum per month from the time the tax was due (or, if paid on the installment basis, on the deficiency of each installment from the time the installment was due), shall be paid upon notice and demand by the collector."

Senator SMOOT. It is just as the House passed it.

Dr. ADAMS. There is no change in the law, except to make it explicit. You must remember that every word and every sentence is contested and fought over, and it is desirable, even at the cost of some space, to say precisely what is intended. There has been no change in the present law from what has been done and is being done up to the present point.

The CHAIRMAN. If there are no objections, that correction will be made.

Dr. ADAMS. The remaining matter here is cut out and is repeated further on:

"If any part of the deficiency is due to negligence or willful disregard of authorized rules and regulations with knowledge thereof, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency in the tax, and interest in such a case shall be collected at the rate of 1 per centum per month on the amount of such deficiency in the tax from the time it was due (or, if paid on the installment basis, on the amount of the deficiency in each installment from the time the installment was due), which penalty and interest shall become due and payable upon notice and demand by the collector. If any part of the deficiency is due to fraud with intent to evade tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes as amended, for false or fraudulent returns willfully made, but in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax 50 per centum of the total amount of the deficiency in the tax. In such case the entire tax, including the penalty so added, shall become due and payable upon notice and demand by the collector."

Senator REED. I would like to ask a question in regard to that. Here is one without fraud:

"If any part of the deficiency is due to negligence or willful disregard of authorized rules and regulations with knowledge thereof, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency in the tax, and interest in such a case shall be collected at the rate of 1 per cent per month on the amount of such deficiency in the tax from the time it was due or, if paid on the installment basis, on the amount of the deficiency in each installment from the time the installment was due,) which penalty and interest shall become due and payable upon notice and demand by the collector."

Now, "due to negligence." The other clause is, "or willful disregard of authorized rules and regulations with knowledge thereof." Now, that is all right. "But without intent to defraud." A man is negligent. He lets his tax go over a day. He is stuck 5 per cent and the 1 per cent interest on the tax. I think that is an excessive penalty.

Senator SIMMONS. One per cent a month.

Senator REED. One per cent a month, 12 per cent annually.

Dr. ADAMS. That is in the present law.

Senator REED. It may be, but we are writing the new law now, and there has been so much in the old law that has made trouble, that I am not very much impressed with the fact that it is there. I think the 5 per cent penalty should go out, if it is a mere case of negligence.

Senator SMOOT. We will have a lot more of them, if you do.

Senator REED. It may be, but I think 1 per cent a month is enough. Take the ordinary delinquent tax law in the States, and very few of them any more pile such awful penalties on. In my State it is 1 per cent a month. Of course, the next month it is 2 per cent. It runs up very rapidly.

Senator CURTIS. We have 2½ per cent in my State and at the end of six months it becomes 5 per cent.

Senator REED. Here is a man with two or three thousand dollars taxes to pay. That is a moderate taxpayer these days. He forgets himself, and he is stuck $100 for forgetting to get a check in the mails by the last day, or the check may be delayed in the mails.

Senator SIMMONS. Senator Reed, we are just reading this over now, with a view of trying to understand it, and we are going back to discuss these matters later.

Senator REED. Very well. Make a note about that.

Dr. ADAMS. In the first place, if the case is wholly innocent, and the taxpayer makes a mistake because he does not know the law, there is no penalty at all. There is the 6 per cent interest charge, one-half of 1 per cent a month. Then you have the second case, of negligence, and in that case you add 5 per cent to the tax, and charge 1 per cent a month interest. Then you have intent to defraud, where the penalty is very heavy.

Senator REED. Is not any failure to pay necessarily negligence?

Dr. ADAMS. We do not hold it so now. The revenue act of 1918, recognizing the great complexities of this subject and the difficulties of it, recognized a class of innocent taxpayers. Here is the language, lines 13 and 14, on page 99:

"In such case, if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty because of such understatement."

Then they go on and recognize the next class:

"If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added, as part of the tax, 5 per centum of the total amount of the deficiency, plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due."

Senator REED. You say "without any fault." Of course, I could hardly imagine a case, with a man's taxes coming due at a certain time that there would be a delay in payment without any fault. Then you come to where a man fails to get his check in the mails. I think 5 per cent is a pretty heavy penalty.

But you say you are simply reading it over at this time, and I will not press the point.

Senator CURTIS. We are reading it now to get an understanding of it, and intend to amend it later on.

Senator SMOOT. That first clause should be stricken out.

Dr. ADAMS. No. We have left it as a residuary class. We have defined the other classes, and left the first class as a remainder. I think it was meant to benefit the taxpayer. That class is left as a residuary class. Unless we can prove fraud or negligence, then they go into the one-half of 1 per cent class.

Senator REED. There is always negligence.

Dr. ADAMS. Senator, that could be proven, I think. I am not in personal touch every day with this part of the income tax work, but I think there is a disposition on the part of the Treasury Department to hold him without fault, unless the taxpayer has been obviously negligent. Perhaps I am wrong about that. That is a matter of policy for you gentlemen. I think to keep in the three classes is a good thing.

Senator REED. Since we are talking about it at this length, I will make this observation and stop:

I have been informed by people in the collector's office in Kansas City that there are hundreds of these cases where men come in and are willing to pay the tax, and have forgotten it for a day or two, and find a penalty stuck on them, and they simply go out mad and cursing the whole Government. It is very natural. I think we ought to get away from irritation where we can. A man might be willing to pay 1 per cent and not complain, but if you put 5 per cent on him he gets mad. I think if you keep on imposing such penalties and heavy taxes, everybody is going to hate the Government anyhow.

Senator MCCUMBER. Do you not find that in the majority of the cases now, a man thinks that he can make out his return, and then finds at the expiration of the period there is some data he has not a correct statement of, and there is a delay on that account. It may be some business somewhere else. I have known of many cases which have come to me to get extensions, because they had failed in making out the return, on account of not having a report from business some distance away, or something of that kind.

Senator SMOOT. All he has to do is to make a request, and it is extended.

Senator MCCUMBER. Suppose he does not find out about it until the last day?

Senator SMOOT. He should have his return in before the last day.

Senator MCCUMBER. I mean the last day on which he could get it in.

Senator REED. Senator Smoot, you must deal with that question in this way. These people have not read this law. If they did read it, they could not understand it. It applies to millions of people to whom it is a holepess muddle, and they forget, and then get stuck 5 per cent. It is harsh. It would be harsh in any law. It would be harsh in a tax law in any State.

Dr. ADAMS. Line 8, page 100:

"If any part of the deficiency is due to fraud with intent to evade tax, then in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns willfully made, but in addition to other penalties provided by law for false or fraudulent returns there shall be added as a part of the tax 50 per centum of the total amount of the deficiency in the tax. In such case the entire tax, including the penalty so added, shall become due and payable upon notice and demand by the collector."

Senator REED. I want to suggest a clause in connection with that.

Senator MCLEAN. What is the penalty in section 3176?

Dr. ADAMS. I do not remember what that is now.

Mr. WALKER. Twenty-five per cent for failure to make the return and 50 per cent for fraudulent return.

Senator REED. You must bear in mind that somebody says you have committed a fraud. You have got to go and pay this tax and pay this penalty, and then maybe afterwards try the case out of whether you can make fraud or not. If you do not succeed, you allow an additional penalty. It is not like paying it at the end of an adjudication. The collector makes a ruling that the taxpayer has made a fraudulent return, and if you do not pay it there is a penalty attached. It does not give a fellow a run for his money.

Senator WATSON. It is pretty hard on him.

Senator REED. It is very hard. It is heavy, but we will go on with the other.

Dr. ADAMS (reading):

"(c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of tax determined to be due under such return shall be paid upon notice and demand by the collector."

Senator MCCUMBER. You refer to section 3176 of the Revised Statutes as amended. How is anyone going to find out what that is without seeing the Revised Statutes and reading them? Why should it not be included instead of the mere reference to it?

Dr. ADAMS. This again is one of those little things. This is a case where an individual does not make a return and the collector goes out and digs up evidence and makes one.

Senator REED. I do not want to do so much talking, but this bill when printed will be found in nearly every lawyer's office and in many business offices, and it should be as nearly complete as we can make it.

Senator CURTIS. That is the intention.

Senator WATSON. It constantly refers to sections of the statutes. You could not possibly include all of them. It would be too voluminous. It constantly refers back to other sections. Do you propose to reprint those sections every time it refers back to them?

Senator MCCUMBER. I see that section is in the law itself.

Dr. ADAMS. I see we have amended it and put it in the law.

Of course, you gentlemen must remember that in the rulings and suggestions which go out, we always either quote the law or abstract it, state its meaning plainly, in all these brief references. This discussion first arose this morning in reference to the section dealing with tax exempt interests.

Senator MCCUMBER. We will escape that somewhat if we rewrite the bill as a full and complete law in itself. Then we can refer back to any section in the law itself.

Dr. ADAMS. Subdivision (d), page 100, line 22. That was stricken out. It reads as follows:

"(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due."

Subdivision (d), page 101:

"(d) The amount of tax due under any return made under this act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the commissioner within three years after the return was filed, and the amount of tax due under any return made under this act for prior fiscal years of under prior income, excess profits, or war-profits tax acts, shall be determined and assessed within five years after the return was filed, unless both the commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceeding for the collecting of any tax under due this act or under prior income, excess profits, or war-profits tax acts shall be begun, after the expiration of five years after the date when such return was filed, but this shall not affect suits

or proceedings begun at the time of the passage of the revenue act of 1921: *Provided*, That in the case of income received during the lifetime of a decedent, all taxes due thereon shall be determined and assessed by the commissioner within one year after written request therefor by the executor, administrator, or other fiduciary representing the estate of such decedent: *Provided further*, That in the case of a false or fraudulent return with intent to evade tax, or of a failure to file a required return, the amount of tax due may be determined at any time after it becomes due: *Provided further*, That in cases coming within the scope of paragraph (9) of subdivision (a) of section 214, or of paragraph (8) of subdivision (a) of section 234, or in cases of final settlement of losses and other deductions tentatively allowed by the commissioner pending a determination of the exact amount deductible, the amount of the tax or deficiency in tax due may be determined, assessed, and collected at any time; but prior to the assessment thereof the taxpayer shall be notified and given a period of not less than thirty days in which to file an appeal and be heard as hereinafter provided in this subdivision."

The paragraph (9) referred to is the amortization deduction, which is given for a very long period. It may continue for three years, or three years after the close of the war with Germany. That makes so much time that you can not limit this to five years.

Senator McCUMBER. Take the portion beginning in line 2, page 102:

"That in the case of a false or fraudulent return with intent to evade tax, or of a failure to file a required return, the amount of tax due may be determined at any time after it becomes due."

That means 25 years or 50 years.

Senator SMOOT. Or one day.

Senator McCUMBER. I do not see why there should be no limitation in a case of this kind. In a case of fraudulent return there is always a question of fact that might be established by evidence, and it does seem to me there ought to be a limitation of the time in which even the Government can attack a return on the ground that it is fraudulent. Why should we keep a taxpayer, who may be innocent of any intent to commit a fraud, and hold him and his children and grandchildren at the mercy of the Government?

Senator REED. A very strong reason in support of that is this—it is really the basic reason for all limitation statutes—that the evidence is gone.

Senator McCUMBER. Yes; the evidence either to prove or disprove.

Senator REED. Yes; the Government may present a strong case of fraud that, if the man had an opportunity to meet it, he could clear it away without any difficulty.

Senator SMOOT. Or the opportunity may not have been given him during his lifetime.

Senator REED. Yes; within 10 years the witnesses may be dead, or his books may be destroyed.

Senator WATSON. It seems to me that point is well taken. That is the basis of all such statutes. There should be some limitation in there. Make a note of that, and we will take it up later.

Senator McCUMBER. In murder there is a statute of limitations, and I do not see why there should not be in a case of this kind.

Dr. ADAMS. The Government would have to prove fraud. There could be no assumption of it.

Senator REED. They have to prove it, but while you may be able to make what appears a perfect case of fraud——

Senator McCUMBER (interrupting). A prima facie case.

Senator REED. Yes. I may have the evidence which explains away every charge, but 10 years from now, when my receipts and vouchers and old papers are gone, or when I am dead and there is nobody to answer for it, my explanation will not be forthcoming.

Senator McCUMBER. That can be taken up at some future time, but I think there should be some limitation, even on the ground of fraud.

Dr. ADAMS. "If, upon examination of a return, a deficiency is discovered, the taxpayer shall be notified thereof and given a period of not less than thirty days in which to file an appeal and show cause or reason why the deficiency should not be paid. The appeal shall be promptly decided after opportunity is given for a hearing thereof, and any deficiency in tax then determined to be due shall be assessed and paid, together with the penalty and interest, if any, applicable thereto, within ten days after notice and demand by the collector as hereinafter provided, and in such cases no claim in abatement of the amount so assessed shall be entertained: *Provided*, That in cases where the commissioner believes that the collection of the amount due will be jeopardized by such delay he may make the assessment without giving such notice."

Senator REED. Let us have the reason for this language in line 21: "And any deficiency in tax then determined to be due shall be assessed and paid, together with the penalty and interest, if any, applicable thereto, within 10 days after notice and demand by the collector as hereinafter provided, and in such cases no claim in abatement of the amount so assessed shall be entertained."

Now, this is a case where there is a deficiency that has been discovered. Let us assume it is a perfectly innocent deficiency, the result of a mistake. Why should there be a penalty assessed in a case of that kind?

Dr. ADAMS. If it is a perfectly innocent case, we say "together with the penalty and interest, if any, applicable thereto." No penalty is assessed if there is no fraud.

Senator REED. Then you say: "In such cases no claim in abatement of the amount so assessed shall be entertained."

Why should you absolutely cut off a claim in abatement which has to be based upon reasonable grounds?

Dr. ADAMS. The situation is this: There is a prescribed procedure that when we determine the assessment we will make an assessment and the collector will give you 10 days' notice and demand, and will proceed to collect it. When that notice is given, then it is due, and may be collected, with penalties and interest. A taxpayer upon receiving that notice or demand, however, may make a claim in abatement, which the collector may accept, purely in the collector's discretion.

Now, two things have resulted, two real evils. In the first place, in times of pressure in the department we rushed these new assessments through pretty rapidly, notified the taxpayer, and proceeded to collect the money. That is one little evil or abuse. Another little evil or abuse is that the taxpayer promptly proceeded to file a claim in abatement. The Treasury Department is not required to accept one single claim. It can go right ahead and shove through the collection. As a matter of fact, it has, however, in ordinary good sense accepted these claims in abatement, but a grave evil has grown up there. The last time I looked it up there were $550,000,000 of outstanding claims in abatement. In other words, we have this situation: Certain of these reassessments, rather hastily made, were then more than half of them held up because of the filing of these claims in abatement. I tried to correct that by what I thought was just procedure. I suggested that no taxpayer should have any additional assessment made against him until he had been notified and given an opportunity to be heard.

Senator REED. That is a good provision.

Dr. ADAMS. We do that now in some cases. We notify the big taxpayer, who is assessed $2,000,000 new taxes, but the little fellow gets a peremtory notice to come in and pay. Every time we change a man's return in the future we have got to notify this man, giving 30 days' notice, and he can be heard to make any explanation he has to make. We can not levy an assessment until he gets that notice, but, that having been done, it seems to me that in good faith and equity and fair dealings with the taxpayers, where the department goes ahead and makes the assessment, I do not see why we should consider any claims in abatement.

Senator REED. Let me ask you one question. Are claims in abatement not frequently made where the taxpayer is able to show there is some equitable ground upon which he should be relieved?

Dr. ADAMS. That is true, but if the Government is finally going to accept that equitable claim it ought to do it. What I want to do is to hasten, not unduly hasten, but to get a prompt registration of the Government's final decision, whatever it may be, acknowledging an equitable claim, or not acknowledging it.

Senator REED. My point is this: You do not provide for that. You say they shall not consider any claims in abatement.

Dr. ADAMS. A claim can be made otherwise. The claim in abatement is not the only way of getting equitable relief. You can make those claims in a number of ways.

Senator REED. Why should not that language be, instead of saying you shall not entertain them, "In such cases all claims in abatement shall be adjudicated?"

Dr. ADAMS. One reason we have had so many claims in abatement is because we have not given the taxpayer an adequate opportunity to be heard.

Senator WATSON. Having done that, why should there be further claims in abatement?

Senator REED. I may not have a correct understanding of this bill, but as I gather this language, the case comes up, he is given 30 days' notice; he goes in and asks, not an abatement of his assessment on equitable grounds, but to show that the tax could not be levied upon legal grounds. Now, the language here deprives the board that is created by Dr. Adams of the power to consider in that case any equitable matters he may bring forward, but says they shall not consider any claims in abatement. What I think you ought to say is that they shall adjudicate and settle all claims in abatement.

Senator SIMMONS. Why could you not remedy that by saying "in such cases no claim in abatement of the amount so assessed shall be entertained until the tax assessed is paid"? After you get the money, then if you want to entertain a claim in abatement the Government will not suffer.

Dr. ADAMS. The real evil is in stringing out this proposition. I do not want to deprive the taxpayer of any reasonable claim, and I think they should receive the fullest consideration, but I want to bring it to a head and have it done with.

Senator REED. Let us see just what this language is:

"If, upon examination of a return, a deficiency in tax is discovered"—that means a legal deficiency—"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 or reason why the deficiency should not be paid."

I take that to mean a legal reason why it should not be paid.

"The appeal shall be promptly decided after opportunity is given for a hearing thereon, and any deficiency in tax then determined to be due shall be assessed and paid, together with the penalty and interest, if any, applicable thereto, within 10 days after notice and demand by the collector as hereinafter provided, and in such cases no claim in abatement of the amount so assessed shall be entertained."

A man comes in and explains that he has not turned in all of his property or there is some other defect. Legally, he owes this money. But there are equitable reasons why he should not be ——

Senator CURTIS. Why could you not improve it by adding the word "equitable"?

Senator REED. That is all right, I think—"and any such claims for abatement shall be determined."

Then you got your prompt decision, Doctor, do you not?

Dr. ADAMS. Senator, I want to do, I think, precisely what you want to have done; but why take two bites at the cherry? We are in a terrific situation of delay, with $559,000,000 worth of taxes backed up in the Treasury Department, due to simply deciding things half way and somebody deciding this much and sending it to some other department, and some other man deciding part of it and sending it to some other department. Why should we not do it in one bite of the cherry?

Senator REED. That is what I want you to do.

Dr. ADAMS. I am perfectly willing to do what you gentlemen want me to do. If you will bring all the claims and appeals together once and decide that the taxpayer shall have a most careful hearing—and I do not want him to be deprived of the slightest right—then when it is done let it be done.

Senator REED. That is what I want, exactly. You provide for a hearing. Thirty days' notice is given. A man comes in and puts in his legal defense, if he has any, but he can not put in his equitable claim, because, by express words, you say he shall not put it in.

Dr. ADAMS. But the equitable claim is no different from the legal claim. They come to the same people. The question has to be decided.

Senator REED. I want it decided right in this one case.

Senator CURTIS. The point the Senator makes is that you make no provision for the equitable claim, and, therefore, in line 17 or 18 you should add the word "equitable."

Senator MCCUMBER. I do not understand what you mean by "equitable."

Senator CURTIS. A man may have a legal claim or an equitable claim.

Senator MCCUMBER. You can not take up any claim that is merely equitable unless it is legal, and I can not understand what you want to gain by putting in the word "equitable." It has got to be a legal claim.

Senator REED. As I understand it, Senator—and I confess that I am speaking here without a very thorough understanding, in fact, with a very meager understanding—they have been granting abatements where, legally, according to the letter of the law, the amount could be exacted, but the claimant is able to show that it would be highly unjust to exact it under the particular circumstances of his particular case. Therefore, they have been granting abatements. Is not that true, Doctor?

Dr. ADAMS. Yes. That is under section 327.

Senator MCCUMBER. Then that is legal.

Dr. ADAMS. It becomes both equitable and legal.

Senator MCCUMBER. There is no discretion, as I understand, in the department as to where they will exact tax and where they will not.

Senator REED. I think you do exercise that discretion, Doctor, do you not?

Dr. ADAMS. No. The only cases in which we ever make any compromises at all are in cases of fraud.

Senator REED. All equity is legal, of course.

Dr. ADAMS. It is exactly the same thing, and the same people pass on it who pass on the other provisions of law. It goes right to the same officials.

Senator REED. Then why not, instead of saying that they shall not consider any question of abatement, say they shall consider all questions of abatement?

Dr. ADAMS. Let us put that in lines 16 and 17.

Senator CALDER. Why did the House write in that no abatement would be made of the amount assessed?

Dr. ADAMS. Because they wanted to get the claims decided.

Senator REED. I may be thinking very crookedly, but if I am not I think you have done exactly the opposite of what you wanted to do. You wanted this all determined in one hearing?

Dr. ADAMS. Yes, sir.

Senator REED. In the last end of it you have cut out the right to consider a plea in abatement. Instead of cutting it out I think you ought to put it in. You are going to have just one hearing where a man comes in and makes his whole defense.

Dr. ADAMS. I think that is not only so, but I think it may help what I want to get at. In lines 16 and 17 suppose we say that full consideration of all claims in abatement shall be made.

Senator REED. Yes; and then you want to take out the language that provides that "in such cases no claim in abatement of the amount so assessed shall be entertained."

Senator MCCUMBER. You already entertain it.

Senator REED. You want to take that out. It should not be there at all. I am always opposed to taking the jurisdiction away from the courts.

Senator LA FOLLETTE. I supposed that we were just reading this bill to get an understanding of it, and not to reframe it.

Senator REED. I think I am the chief offender. I do not get an understanding by mere reading unless I ask questions.

Dr. ADAMS. Line 6, page 103:

"If any tax remains unpaid after the date when it is due, and for 10 days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons there shall be added as part of the tax the sum of 5 per cent on the amount due but unpaid, plus interest at the rate of 1 per cent per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement filed within 10 days after notice and demand by the collector, where the taxpayer has not had the benefit of the notice and the 30-day period for filing an appeal as provided in subdivision (d), such sum of 5 per cent shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of one-half of 1 per cent per month on that part of the claim rejected.

"In the case of the first installment provided for in subdivision (2) the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due."

Subdivision (f) is stricken out. I will read it, however:

"In every case in which in order to enforce payment of a tax it is necessary for a collector to cause a warrant of distraint to be served, there shall also be added as part of the tax the sum of $5."

I will read subdivision (g):

"If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer terminated at the end of the calendar month then last past and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of said tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any action or suit brought to enforce payment of taxes made due and payable by virtue of the provisions of this subdivision the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any act of Congress may furnish to the United States, under regulations to be prescribed by the commissioner with the approval of the Secretary, security approved by the commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The commissioner may approve and accept in like manner

security for return and payment of taxes made due and payable by virtue of the provisions of this subdivision, provided the taxpayer has paid in full all other income, war profits, or excess-profits taxes due from him under any act of Congress. If security is approved and accepted pursuant to the provisions of this subdivision and such further or other security with respect to the tax or taxes covered thereby is given as the commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this subdivision prior to the expiration of the time otherwise allowed for paying such respective taxes."

That is the present law. It relates particularly to foreigners who are about to leave the country without paying their income taxes.

Senator SIMMONS. That is the present law. What is the use of reading that? Could you not just tell us about what that embraces down to the amendment, for the purpose of explaining the amendment?

Dr. ADAMS. I have been doing that, but this——

Senator SIMMONS. We have been here a solid week and we are not more than one-third through this bill, just reading it over.

Dr. ADAMS. This is the first time we have read any part of the old law, Senator. I did that on suggestion.

Senator SIMMONS. We commenced to do it, and I think it takes up too much time.

Senator REED. I will bet you, Senator, that we will take more time explaining it than in reading it.

Senator SIMMONS. When we started out the Doctor did explain some provisions of the old law that were brought forward so as to enable us to understand the amendments; and that is all we want to do. But if we go on now reading this whole bill, as he has read these two pages, we will be here three weeks before we get to the end of it, and we have not yet considered action at all. We have just been trying to understand it. We have been here a solid week.

Dr. ADAMS. This section authorizes the commissioner in exceedingly summary and really harsh ways to get after a man who is about to leave the United States, and collect his tax. This applied not only to aliens, but to citizens, and the first correction that is made is at line 23, page 105, relating to a citizen of the United States——

"In the case of a citizen of the United States about to depart from the United States the commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this subdivision. No alien shall depart from the United States unless he first accures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war profits, and excess profits tax laws. If a taxpayer violates or attempts to violate this subdivision there shall, in addition to all other penalties, be added as part of the tax 25 per cent of the total amount of the deficiency in the tax, together with interest at the rate provided by this section in the case of the filing of a false or fraudulent return."

Senator REED. I wonder what you did with a case like that of Emma Goldman, who was forced to leave the country but could not go, under this provision, until her taxes were paid.

Dr. ADAMS. Well, so far as I am concerned, gentlemen, you can take that whole subdivision and wipe it out. There has been a fraud there. There are a great many foreigners who left the country during the war and got away with a good many taxes. On the other hand, the attempt of the Government to enforce this has led to a great deal of harshness.

The Treasury Department will care nothing about it if you wipe it out or leave it in. If you desire to leave it in, we have softened it in the case of a respectable citizen; instead of demanding that he shall get from the Department of State an actual statement on his passport that he has paid his income tax, we send him to the collector.

RECEIPTS FOR TAXES.

The next section, 251, simply provides for receipts for taxes. No change in the law is made. It provides that the collector shall give a receipt.

Senator REED. The burden ought to be put on the Government, gentlemen, of showing that a man is leaving for the purpose of defrauding the Government, in the case of a citizen. The leading lawyer in my State, a wealthy man, was held up down here in regard to his taxes. Judge Priest could not get a passport to go to Europe for 60 days on some business.

Senator MCLEAN. Under this provision he would not have any trouble.

Senator REED. He would have to come down here and tell some one.

Senator MCLEAN. Not necessarily. He would have to communicate with the department.

Senator REED. The people of the United States are not subjects. They ought to be treated like white men when they want to leave this country, unless somebody has a good reason to think that there is some fraud. There ought to be a clause in here that if they have reason to believe that they are going for the purpose of evading taxes ——

Senator MCCUMBER. But when you provide that the commissioner must find that such is the intent, does not that place the burden of proof upon the Government?

Senator REED. That is not the way this reads.

Senator MCCUMBER. Yes; at the very beginning, on page 104, subdivision (g) says:

"If the commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein," etc. He must make a finding, according to that.

Senator REED. This includes more than that, Senator:

"If the commissioner finds that a taxpayer designs quickly to depart from the United States"—now let me read on—"or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice"—if he simply finds that there is a design to depart quickly from the United States, he can act.

Senator MCCUMBER. No: it has got to be done for the purpose of prejudicing or rendering wholly or partly ineffectual the proceedings to collect.

Senator REED. I do not quite agree with that.

Senator CURTIS. We can discuss that when we go to amend it, can we not?

Senator REED. Yes.

Senator MCCUMBER. "Or to do any other act tending to prejudice." The word "other" relates to all that has passed, and they must all be done to prejudice the collection, and the commissioner has to make a finding.

Senator REED. Do you not think the language ought to be that if the commissioner finds that he is about to depart for the purpose of doing this?

Senator MCCUMBER. That is the way I construe it now.

Senator REED. If it means that, it is all right.

Senator MCCUMBER. I think that is the only thing it could mean.

Dr. ADAMS. Then comes the very important section on refunds, page 107, on which no change has been made except the proviso on page 108. That section provides, in general, that a man can get a refund for taxes, provided—line 23, page 107—"That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer: *Provided further*, That if upon examination of any return of income made pursuant to the revenue act of 1917 or this act the invested capital of a taxpayer is decreased by the commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, then, notwithstanding any other provision of law and regardless of the expiration of such 5-year period, the amount of such excess shall, without the filing of any claim therefor, be credited or refunded as provided in this section."

That is a liberalizing provision.

Senator SMOOT. It is a liberalizing provision, and you would have to go all over it again.

Dr. ADAMS. This is the point, Senator: The section puts a five-year limitation on refunds, but in some cases, in checking up the invested capital of a taxpayer, which depends upon his surplus and earnings for prior years, we go back and say, "You did not take enough deduction prior to that five-year limitation. Your surplus is really less than you claim it is, because you did not take proper deductions."

If we did that and cut down his present surplus, it works to his credit. It has seemed to a great many taxpayers and to the House committee that we ought to give a rebate for the taxes paid in those former years.

Senator SMOOT. This only opens another way of keeping these unsettled taxes for years and years and years to come. For God's sake let us get them wound up in some way.

Dr. ADAMS. This will be wound up with the excess-profits tax. It has no meaning without it.

The next heading is "Penalties." There is no change in the penalty provision at all.

"Returns of payments of dividends." There is no change there.

"Returns of brokers." There is no change in that.

The next heading is "Information at source," on page 110. There is no change in that.

Mr. WALKER. Except the rate.

Dr. ADAMS. I beg your pardon, gentlemen. In line 9 there is a change that really ought to be called to your attention. On page 110, line 9—this is the provision requir-

ing information to be gotten at the source, and it was provided in the prior law that the Government might call for returns of incomes of $1,000 or more in any taxable year. That is, if you pay a man's salary or wages in excess of $1,000 a year, the Government could call for a return of information regarding that. The American Institute of Accountants, and public accountants generally, in a series of recommendations made formally by them, suggested that in order to make it more easy to compute and ascertain what kind of payments had to be required, the words "at the rate" be inserted.

This frightened many taxpayers, by the way. The Treasury Department cares nothing about this. They recommended it in the belief that it was facilitating these returns, making it easier for the taxpayer in accordance with the suggestions of the people who were most concerned, namely, the accountants of the country.

The CHAIRMAN. I have a letter, Dr. Adams, from Mr. A. J. County, the vice president of the Pennsylvania Railroad Co., and one of the ablest men in the United States, protesting against this very provision that you have here. I am going to ask the stenographer to put it in the notes.

(The letter referred to and submitted by the chairman is as follows:)

THE PENNSYLVANIA RAILROAD CO.,
Philadelphia, September 3, 1921.

Hon. BOIES PENROSE,
United States Senate, Washington, D. C.

MY DEAR SENATOR PENROSE: I do not know whether your attention has been called to the very innocent looking change in section 256, page 110, line 9, of the revenue bill, consisting of three words "at the rate." If these words are inserted it means that for every employee who works for one day every corporation, partnership, etc., will be required to make a return setting forth the name, address, amount, etc., of anybody paid "at the rate of $1,000 or more in any taxable year."

I think this is very unwise as well as unnecessary, because "John Smith" may receive 40 cents an hour or $3 a day for a day's work, which would be at the rate of $1,000 per annum and a return must be rendered. The same "John Smith" may work for a dozen or more different corporations during the year, all of whom are supposed to take similar action. This is done on the supposition that the same "John Smith" will be followed up wherever he goes, and these returns will be added together to ascertain what tax, if any, he should pay. We know that it is impossible for the tax commissioners or bureaus to follow out any such procedure, and this would be more hurtful to them than helpful, and at the same time would be an unnecessary burden on individuals and corporations.

I hope the suggested amendment of three words will be omitted. The labor and expense is already bad enough to deal with the $1,000 lists of employees.

Kindest personal regards.

Very truly, yours,

A. J. COUNTY, *Vice President.*

Dr. ADAMS. If the administration of this portion of the law is unsatisfactory, it is primarily the department's fault and responsibility, because you have given in the past, and you still give, almost complete discretion with respect to this.

Senator SMOOT. What is the real reason for putting in "at the rate of?"

Dr. ADAMS. Let us get at it, Senator. Take a concern that has, as the Pennsylvania Railroad has, we will say, 25,000 employees. If it takes its duties conscientiously, it has to make a return to the Government of the amount paid to every employee getting more than a thousand dollars a year. In order to ascertain that, it has to keep a check and record of every employee.

Senator SMOOT. So you just simply say "at the rate of $1,000"?

Dr. ADAMS. It does not have to keep a check on anybody that is paid less than that rate.

Senator SMOOT. That is what I thought, and that is why I wanted to get it in the record.

The CHAIRMAN. Go on, Doctor.

Dr. ADAMS. There is no change in the "returns to be public records," found in section 257, page 111. There is no change in the publication of statistics; no change in the collection of foreign items, or in the section relating to citizens of the United States possessions, on page 113. There is no change at all in the provisions relating to Porto Rico until we get to page 115; and that provision is one of those fiscal year propositions relating to what shall be done when the tax rate and the basis of the tax are changed. It is complex.

Beginning at line 4, page 115, it repeals the excess-profits tax to take effect January 1, 1922.

Line 6: "(b) If a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1920 and ending in 1921, the war-profits and excess-profits tax for the taxable year 1921 shall be the sum of: (1) the same proportion of a tax for the entire period computed under the revenue act of 1918 (as in force prior to the passage of this act) which the portion of such period falling within the calendar year 1920 is of the entire period, and (2) the same proportion of a tax for the entire period computed under the revenue act of 1918 (as in force on December 31, 1921), which the portion of such period falling within the calendar year 1921 is of the entire period. Any amount heretofore or hereafter paid on account of the tax imposed for such taxable year by the revenue act of 1918 (as in force prior to the passage of this act) shall be credited toward the payment of the tax as above computed, and if the amount so paid exceeds the amount of such tax, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252 of the revenue act of 1918.

"(c) If a corporation (other than a personal service corporation) makes a return for a fiscal year beginning in 1921 and ending in 1922, the war-profits and excess-profits tax for the portion of the year falling within the calendar year 1921 shall be an amount equivalent to the same proportion of a tax for the entire period computed under the revenue act of 1918 (as in force on December 31, 1921) which the portion of such period falling within the calendar year 1921 is of the entire period.)"

Senator REED. What do you mean by personal service corporation?

Dr. ADAMS. That is a corporation whose officers actively participate in the conduct of the corporation and in which capital is not an income-producing factor.

Senator CURTIS. We had that up the other day, Senator.

Senator REED. I did not know. If it is defined somewhere in the bill it is all right.

Dr. ADAMS. Line 9, page 116, tells when it takes effect:

"This title shall take effect as of January 1, 1921, except sections 206, 207, 224 237, 241, 242, 245, 250, and 903, and subdivision (b) of section 202, all of which shall take effect January 1, 1922."

Those are the special taxes designed to take effect on January 1, 1922. Title III is the excess-profits tax, which is stricken out, the abolition being effective as of January 1, 1922.

Let us go to page 138. Taking up estate taxes, there is no change until we reach subdivision (d) on page 141. The present law is very severe on estates held jointly or as tenants in entirety, and to liberalize that the following provision has been incorporated:

This, gentlemen, I may say, states the elements that are included in the estates subject to tax. Section 402 says: "That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated." Then it takes up various kinds of property, particularly when there is any doubt about it. I will read subsection (d) as amended:

"To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than a fair consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than a fair consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy in the entirety by the decedent and spouse, or where so acquired by the decedent and any other person as joint tenants and their interests are not otherwise specified or fixed by law, then to the extent of one-half of the value thereof."

Senator WATSON. In my State there could be no such thing as a tenancy in entirety except between husband and wife.

Dr. ADAMS. There may be tenants in entirety by decedents other than husband and wife.

Senator WATSON. There is not in my State. There is a joint estate, but not in entirety.

Senator SMOOT. Would this affect the dower right of the wife? We give her, for instance, one-third of the estate, and not one-half.

Dr. ADAMS. No; that is included under the estate tax at the present time. If the husband dies that is included in the value of the estate. If you will read the old

law on this subject you will see how it was—page 141. That has not been affected by this. Under the present law, line 16, page 141, it is provided:

"To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either of the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent."

There are lots of mixed intermediate cases which really should not be included, but yet do not comply with the condition there imposed: "Except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent."

Senator SMOOT. I see that it is taken care of by (b) on page 140.

Dr. ADAMS. Yes, sir. It is somewhat softening that provision of the law in favor of the taxpayers concerned and, I think, where it is deserved.

Page 143, line 21: "An amount equal to the value at the time of the decedent's death of any property, real, personal, or mixed, which can be identified as having been received by the decedent as a share in the estate of any person who died within five years prior to the death of the decedent, or which can be identified as having been acquired by the decedent in exchange for property so received, if an estate tax under the revenue act of 1917 or under this act was collected from such estate, and if such property is included in the decedent's gross estate."

Senator WATSON. What does the part that you have skipped refer to.

Dr. ADAMS. It deals with the deductions in determining the value of a net estate. Where a man dies and leaves property to his wife, and his wife dies within a year, it does not seem just to tax them both, and a period of five years is imposed. That has given rise to some abuses. The period of five years is not changed, but this point is made in the amendment that I am about to read. The property is only exempt at the value at which it was first taxed. For instance, if John Smith dies in 1918 and leaves a farm which is assessed for an estate tax at $15,000, he leaves it to his wife and it is taxed at $15,000. Suppose his wife, in turn, dies within three years, but the farm has come to be worth $20,000. In that event the amendment provides that the deduction shall only be at the value at which it was originally taxed—$15,000.

Then, on the other hand, if the farm has gone down in value to $10,000, they can still take the higher value.

Senator SMOOT. Do they always take the tax value of it?

Dr. ADAMS. At the present time the situation is even worse than that. The property may have been exempt. For instance, there are certain kinds of property that are wholly exempt from estate taxation. The present law not only will let you exempt it but in turn if it is subject to the inheritance tax within five years they give you a double exemption for it. Both these defects are corrected in the proposed amendment, and I will read the language at page 144, line 6:

"An amount equal to the value of any property forming a part of the gross estate of any person who died within five years prior to the death of the decedent where such property can be identified as having been received by the decedent from such prior decedent by gift, bequest, devise, or inheritance, or which can be identified as having been acquired in exchange for property so received: *Provided*, That this deduction shall be allowed only where an estate tax under the revenue act of 1917 or this act was paid by or on behalf of the estate of such prior decedent, and only in the amount of the value placed by the commissioner on such property in determining the value of the gross estate of such prior decedent, and only to the extent that the value of such property is included in the decedent's gross estate and not deducted under paragraphs (1) or (3) of subdivision (a) of this section."

The next change is at the bottom of page 145 and merely repeats what we have been over as applicable to the case of a nonresident. It is exactly the same thing but dealing with a nonresident. Unless some gentleman calls for it I shall not read it.

The CHAIRMAN. Proceed, Doctor.

Dr. ADAMS. The next change is on page 147 and merely strikes out the provision. At the present time all insurance taken out by foreigners in American companies is subject to our estate tax. If a resident of Canada takes out a $100,000 insurance in an American company and he dies, that $100,000 is subject to our estate tax.

Two things have happened, but the principal thing is that it is stimulating Canada to introduce, I am told, retaliatory legislation. I think it is a very unfortunate situation. It holds up these payments, and it is of doubtful philosophy in the first place that we should attempt to cover in our inheritance tax or estate tax insurance taken out by foreigners. At any rate it is stricken out in the House bill, and it is shown specifically on page 148, lines 3 to 9, providing as follows:

"The amount receivable as insurance upon the life of a nonresident decedent, and any moneys deposited in any bank, banking institution, or trust company in the United States."

In other words, this is exempting two classes of property owned and held by nonresidents which have hitherto been subject to our estate tax, namely, insurance in American companies, life insurance, and deposits in American banks where the nonresident alien does not live here or do business.

Senator WATSON. Do you know how much revenue that amounts to?

Dr. ADAMS. Almost nothing, practically nothing. Finally:

"Missionaries duly commissioned and serving under boards of foreign missions of the various religious denominations in the United States, dying while in the foreign missionary service of such board, shall not, by reason merely of their intention to permanently remain in such foreign service, be deemed nonresidents of the United States, but shall be presumed to be residents of the State, the District of Columbia, or the Territories of Alaska or Hawaii wherein they respectively resided at the time of their commission and their departure for such foreign service."

You gentlemen probably all understand that. The missionary societies have been asking for that.

The CHAIRMAN. Senator Wadsworth has written a special letter on this paragraph, and this is exactly as the missionaries and he wanted it.

Dr. ADAMS. There is no change on page 149 or on page 150, but we come to an important change on page 151, relating to the collection of the estate tax, and it is designed to facilitate its assessment, to avoid delays, and particularly to relieve executors who want to have things cleared up and have their liability finally settled. I will read that:

"If the executor files a complete return and makes written application to the commissioner for determination of the amount of the tax and discharge from personal liability therefor, the commissioner, as soon as possible and in any event within one year after receipt of such application shall notify the executor of the amount of the tax, and upon payment thereof the executor shall be discharged from personal liability for any additional tax thereafter found to be due, and shall be entitled to receive a receipt or writing showing such discharge: *Provided, however*, That such discharge shall not operate to release the gross estate from the lien of any additional tax that may thereafter be found to be due 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."

That provides for a more rapid settlement of these claims.

We come now to Title V, relating to tax on transportation and other facilities, and on insurance.

The CHAIRMAN. That is a departure into an entirely new atmosphere, a new part of the bill.

Dr. ADAMS. It is not necessary to read anything there. I can tell you in two minutes what has been done.

The CHAIRMAN. I was only going to make the inquiry of this committee as to whether they desire to go on.

Senator CURTIS. We can get 15 pages finished in 15 minutes. Let us go ahead.

The CHAIRMAN. Very well; proceed, Doctor.

Dr. ADAMS. Title V imposes a 3 per cent tax on freight transportation, and 8 per cent tax on Pullman berths and passenger transportation; approximately a 5 per cent tax on express, and 8 per cent on transportation of oil by pipe line; a tax which varies from 10 to 30 per cent on telephone and telegraph messages, and taxes, for the most part, of 1 per cent on insurance proceeds. All of those taxes are abolished.

Senator SIMMONS. What do you mean by insurance proceeds, Doctor?

Dr. ADAMS. The premiums collected. All of those taxes have been repealed by the House, to take effect January 1, 1921, except the taxes on telephone and telegraph messages. Of the total proceeds of that title probably $300,000,000 a year, there has been left in simply the tax on telephone and telegraph messages.

Senator SIMMONS. That is not effective until 1922?

Dr. ADAMS. That is correct.

Senator SIMMONS. It does not take effect right now?

Dr. ADAMS. No, sir.

Senator LA FOLLETTE. That makes a net loss of how much in revenue?

Dr. ADAMS. Close on to $300,000,000, I think.

Senator CURTIS. I think we will want to go over some of these items.

Dr. ADAMS. You will have to think about that very carefully. It is not at all technical. This just wipes it right out.

Senator SIMMONS. All these taxes are collected by the transportation corporations?
Dr. ADAMS. Yes, sir.
Senator SIMMONS. They fix their rate and then add this tax to the rate which they are permitted to charge.
Dr. ADAMS. That is true of the transportation tax. Some of the insurance companies say they do not.
Senator SIMMONS. I am talking about transportation companies, now, not insurance companies.
Dr. ADAMS. They are purchasers' taxes collected by the companies.
The CHAIRMAN. When you buy a ticket they put on the tax at the office and the traveler pays for it?
Dr. ADAMS. Yes, sir.
Senator SIMMONS. They charge the amount that they are permitted to charge by the Interstate Commerce Commission, and then add this freight tax or passenger tax?
Dr. ADAMS. Yes, sir.
The CHAIRMAN. On what ground is that particular tax taken off rather than taking it from something else?
Dr. ADAMS. For the general relief of taxpayers, and on account of the general belief that it helps to raise prices, particularly farm prices.
Senator SMOOT. To relieve high freight rates.
Dr. ADAMS. It has been the cause of some irritation, of course.
Senator MCLEAN. That takes off the Pullman tax?
Dr. ADAMS. Yes, sir. On page 165 we come to Title VI—Tax on beverages.
Senator DILLINGHAM. Did you take up page 159?
Dr. ADAMS. Those are insurance taxes. They are all stricken out.
Senator SIMMONS. Why did they not include telegraph and telephone messages?
Dr. ADAMS. I do not understand, sir. They simply did not get around to it. I suppose they were not asked for it.
Senator CURTIS. I do not understand why they should exclude Pullmans.
Dr. ADAMS. The Pullman tax has been repealed.
Senator CURTIS. That is what I say.
Senator SIMMONS. You do not understand why they repealed that tax?
Senator CURTIS. No.
Senator SIMMONS. That was in addition to the Pullman charge. The Pullman charge is regulated by the Interstate Commerce Commission.
Senator CURTIS. I think we ought to pay for it. It is a luxury.
Senator SIMMONS. That raises another question.
Senator CURTIS. Certainly. We will discuss that when we get down to the bill. Go ahead, Doctor.
Senator SMOOT. Mr. Chairman, it is now half past 1, and we are over to page 176. At the next sitting we can get through the balance of the bill. Why not take a recess until 10.30 o'clock to-morrow morning?
The CHAIRMAN. The committee will stand adjourned until 10.30 o'clock to-morrow morning, and it is hoped that we can finish this method of going through the bill.
(Whereupon, at 1.30 o'clock p. m., the committee adjourned until to-morrow, Wednesday, September 7, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

WEDNESDAY, SEPTEMBER 7, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Reed, Walsh, and Simmons.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. The committee will come to order.

STATEMENT OF DR. T. S. ADAMS—Resumed.

Dr. ADAMS. On page 176, lines 7 to 13, the present processes of making absolute alcohol in some cases fall under the rectification tax. In order to take that out, it is provided that—

"The process of extraction of water from high-proof spirits for the production of absolute alcohol shall not be deemed to be rectification within the meaning of section 3244 of the Revised Statutes, and absolute alcohol shall not be subject to the tax imposed by this section, but the production of such absolute alcohol shall be under such regulations as the commissioner, with the approval of the Secretary, may prescribe.

I think there is nothing new until you get a very long distance on from this point.

We pass to page 196, sections 628 and 630, which impose certain taxes on soft drinks.

The tax on "near beer" or cereal beverages has been changed from 15 per cent ad valorem to a tax of 4 cents per gallon.

That is the only change of rates there.

Senator CURTIS. How much difference will that make?

Dr. ADAMS. There is a good deal of difference of opinion as to what the 15 per cent rate amounts to, and Mr. McCoy will know that better than I. The statements vary all the way from 10 cents a gallon to 4 cents a gallon. The probabilities are that it would yield about 6 cents. That has been reduced to 4 cents in the House bill.

The CHAIRMAN. Why so?

Dr. ADAMS. The House started out with the notion of increasing that and changed the 15 per cent ad valorem to 15 cents a gallon, but the near-beer people made out a convincing case that the industry is not making money now, that it is just trying to replace the old-beer industry with the near-beer industry and is in a rather critical stage. Is not that your impression, Mr. McCoy?

Mr. MCCOY. Yes.

Dr. ADAMS. And the House reduced the rate to try to let the industry get on its feet. I think the present tax of 4 cents might yield almost as much money.

Mr. MCCOY. That is a higher tax than the old tax on beer used to be.

The CHAIRMAN. What is a higher tax?

Mr. MCCOY. It is a higher tax on near beer than the tax on beer was before prohibition. It was a dollar a barrel of 31 gallons, and that is about 3 cents a gallon on beer. This is 4 cents on near beer, which is nonalcoholic.

Dr. ADAMS. There is a notion that the industry is making a great deal of money. That is wrong, I believe. They are selling a good deal of near beer, but they have a long distance to go yet.

Senator SIMMONS. Is this intended to catch beer?

Dr. ADAMS. Near beer.

The CHAIRMAN. The present tax is 15 per cent ad valorem?

Mr. McCoy. Yes, sir.
The CHAIRMAN. On all beverages?
Dr. ADAMS. On all cereal beverages. They were beginning to evade that tax in certain ways, and this prevents that evasion.
The CHAIRMAN. Why did we make a different amount for the other beverages? I have forgotten.
Mr. McCoy. I do not know, Senator. The other beverages are much cheaper to make than near beer, and they are taxed lower.
Dr. ADAMS. There was a fight made with regard to grape juice and loganberry juice. You will recall that fight?
The CHAIRMAN. Very well.
Senator SIMMONS. Before we leave this, which is very important, it seems to me that we can not discriminate because fights are made. Special interests will fight, and it is not our business to yield to them.
Dr. ADAMS. The Senator was asking about the present law.
Senator SIMMONS. I want to find out how it is. Here is a tax on grape juice and loganberry juice and that sort of thing.
Dr. ADAMS. You had in the present law——
Senator SIMMONS. I am not talking about the present law, but the House rates.
Dr. ADAMS. 2 cents a gallon.
Senator McCUMBER. What was the old law?
Dr. ADAMS. The old law was 10 per cent ad valorem.
Senator SIMMONS. Mr. McCoy, what is the reason for a tax of 2 cents on grape juice, per gallon, and 4 cents on beer made of cereals, corn, and things of that kind?
Senator McCUMBER. The difference between water and berry juice.
Mr. McCoy. One is an extract of grain and the other is an extract of fruit.
Senator SIMMONS. I know that.
Mr. McCoy. Near beer is alcoholic and it should be taxed greater. But there is no more alcohol in it than there is in any of these other beverages.
Senator SIMMONS. How much alcohol is there in grape juice?
Mr. McCoy. One-half of 1 per cent.
Senator SIMMONS. But 1 per cent is allowed in near beer?
Mr. McCoy. One-half of 1 per cent.
Senator SIMMONS. It is the same thing?
Mr. McCoy. Yes, sir.
The CHAIRMAN. Did we not start originally with the tax the same on fruit juice and on cereal beverages?
Mr. McCoy. I think we did; and then there was a great deal of opposition by the fruit-juice producers.
Senator McCUMBER. We all know that it costs five times as much to make a pint of grape juice or of loganberry juice as it does to make a pint of near beer.
The CHAIRMAN. I do not know about that.
Senator SMOOT. I do not think so.
Senator McCUMBER. There is a little brewing and no alcohol, practically, in it. It does not cost much of anything to make it.
Senator SIMMONS. If it costs five times as much to make a gallon of wine as it costs to make a gallon of beer, why should beer be taxed 4 cents and wine only 2 cents? It ought to be the other way, ought it not?
Senator McCUMBER. I do not think so. I think those who make so much money upon near beer at the prices at which they sell it ought to pay a larger tax. One is a food and the other is nothing.
Senator SIMMONS. Grape juice is a food.
Senator McCUMBER. I say it is a food. There is material in it and there is cost in it. But when you come to take a little malt and one-half of 1 per cent of alcohol and the rest all water——
Senator SIMMONS. My idea was that we were discriminating against the kind of product which is produced in your section.
Senator McCUMBER. There is none of it produced in my section.
Senator SIMMONS. Do you not produce hops in your section?
Senator McCUMBER. No, sir. They make near beer and sell it for 20 cents a bottle, a little bottle with one drink in it; and you would go crazy if you had to pay that much for good, rich milk.
Senator SIMMONS. We make wine and we do not make any beer in my country: but I can not see why wine should be taxed only 2 cents and beer 4 cents. It seems to me that one ought to be taxed as much as the other.
Senator McCUMBER. I did not know you made wine at all now. I thought you could not make it under the Constitution.

Senator SIMMONS. Grape juice is a sort of wine, but there is not much alcohol in it.
Senator MCCUMBER. It is a food.
Mr. MCCOY. There is a still further distinction. Beverages like ginger ale, etc., are taxed much less, while they sell for practically the same prices. If you had a bill of fare from the Senate restaurant here you would see that table waters sell just as high as near beer at the restaurant, and there is no tax whatever on the table waters.
Senator MCLEAN. What is the difference in the cost?
Mr. MCCOY. The cereal beverage costs more to make than any other beverage. The grape juice is never drunk concentrated. When it is diluted it costs less than the cereal beverage, pint for pint—considerably less.
Senator MCCUMBER. You mean you pay less for it?
Mr. MCCOY. There is no cereal beverage manufacturer in the country now who is making any profit whatever. The great trouble is that they are overcapitalized. It is a remnant of the old brewery. They have to make real beer. With very few exceptions real beer is made and then the alcohol is extracted from it.
Senator MCLEAN. They charge to-day as much for it as they used to charge for beer.
Mr. MCCOY. It costs more to make it.
Senator MCCUMBER. It costs almost double what you used to pay for beer.
Senator SMOOT. It costs more to make.
Mr. MCCOY. They have not quantitative production yet. If they could sell as much as they could of the real beer they could afford to pay a tax, but they can not sell it.
Senator SIMMONS. Why should Coco-Cola——
Mr. MCCOY. That pays only 2 cents a gallon.
Dr. ADAMS. No; Coco-Cola pays more. It is 10 cents a gallon.
Mr. MCCOY. That is the extract. You do not drink it undiluted. Out of a gallon of the concentrated extract you can make a barrel of it.
Dr. ADAMS. But if you get the concentrated extract it is 10 cents a gallon. I think you gentlemen better read the section on page 197.
Senator LA FOLLETTE. You do not know how much grain they use in making this beverage, do you?
Dr. ADAMS. Near beer?
Senator LA FOLLETTE. Yes.
Dr. ADAMS. They use very large quantities of grain.
Senator LA FOLLETTE. I was wondering how much of a market it made for grains.
Mr. MCCOY. They use a very large amount of barley and a very large amount of rice.
Senator SIMMONS. The point I have in mind is this, that these various drinks—near beer, wine, grape juice, and soft drinks generally—should be placed in the schedule on some sort of an equality of treatment in taxation.
The CHAIRMAN. I think it would be well if we should discuss one subject at a time.
Senator SIMMONS. The reason I was bringing this up, Mr. Chairman, was to find out exactly how it was.
The CHAIRMAN. I know; we want to find out.
Senator SIMMONS. I do not think that because some interest representing loganberry juice or grape juice comes here and makes a powerful appeal to us, we ought to tax them one-half of what we tax another concern that makes a beverage that sells for about the same.
Senator MCCUMBER. One is a beverage; the other is used in hospitals for sick people, for food purposes. You all know that it costs much more to get real berries or grapes and crush them and take the juice out of them than to make a beverage out of a little water and malt.
Dr. ADAMS. I think these various taxes have been designed to yield perhaps as near as can be obtained an equal tax on the drink when it finally emerges. For instance, on this grape juice at 2 cents a gallon, that would be the same on the retail selling price at 4 cents on cereal beverages. I know that the effort has been made on all soft drinks to get the tax about the same amount.
Senator MCLEAN. Based on cost?
Dr. ADAMS. No; based on selling price. You can not tell about the costs. What is the use of discussing cost in this sense? The cost of the near beer is very largely the cost of advertising it and trying to keep up volume production and getting it around. I do not know what the cost of the grain is which goes into it, but the cost of maintaining a very large brewery and advertising and getting a market is a large part of the cost until they can get volume production.
Senator MCLEAN. On just what do you base your tax?
Dr. ADAMS. There has been no absolute or satisfactory evidence on the respective costs of these things, except that the near beer people have put in convincing state-

ments, I think, that they are losing money. Anheuser-Busch, for instance, is losing seven or eight hundred thousand dollars a year at the last returns, and more than that in the relatively near past. They are trying to work up a sale which will enable them to manufacture at a profit. They have been in grave doubt at times as to whether to continue, but they have a large plant and a lot of skilled employees that they want to retain, and they have been trying to work up a volume production which will enable them to sell at a profit.

Senator SMOOT. They have got to have the same plant that they had before in manufacturing beer, together with a great deal of other machinery for the purpose of extracting alcohol.

Dr. ADAMS. The rate on near beer has been fixed largely by political or general considerations, I think, working up and down. The other rates are rather designed to bring out some quality in the tax for the drink as it finally emerges.

For instance, a great many of these soft drinks are sold in concentrated form. Coco-Cola, for instance, into which the druggist or vendor puts carbonated water. That is taxed at 10 cents. That is a concentrated extract. On distilled drinks the tax is 3 cents on some drinks and 2 cents on others.

There is also a tax on the gas itself of 5 cents a pound. The design of that has been so far as practicable—it is not possible to get an exact equality—to bring out an equal tax per drink. The near beer rather stands by itself and was the result of a compromise.

Senator SIMMONS. You have this situation, then: On beer that costs so much to make, according to Senator Smoot, you put a tax of 4 cents, and you put a tax of only 2 cents on this Coco-Cola, stuff that costs nothing to make. It is absurd, to my mind. The thing that costs a lot of money to produce does not sell for practically any more than the Coco-Cola does, over the counter, from the fountain, and yet you put twice as much tax on it.

Senator SMOOT. One is called a substitute for beer and the other is called a dinner drink.

Senator LA FOLLETTE. Coca-Cola is not a dinner drink. It is a heart stimulant.

Senator SMOOT. I am speaking now of fruit juices. Coca-Cola ought to be abolished entirely.

Dr. ADAMS. Page 197. The cereal beverage is taxed at 4 cents a gallon as stated. Then we take up (b), which reads as follows:

"Upon all unfermented fruit juices, in natural or slightly concentrated form, or such fruit juices to which sugar has been added (as distinguished from finished or fountain sirups), intended for consumption as beverages with the addition of water or water and sugar, and upon all imitations of any such fruit juices, and upon all carbonated beverages, commonly known as soft drinks (except those described in subdivision (a), manufactured, compounded, or mixed by the use of concentrate, essence, or extract, instead of a finished fountain sirup, sold by the manufacturer, producer, or importer, a tax of 2 cents per gallon."

Senator MCLEAN. That includes grape juice?

Dr. ADAMS. Not the ordinary grape juice. The ordinary grape juice comes up under this section because it is intended to be diluted a little.

Subdivision (c):

"Upon all still drinks, containing less than one-half of one per centum of alcohol by volume, intended for consumption as beverages in the form in which sold (except natural or artificial mineral and table waters and pure apple cider), sold by the manufacturer, producer, or importer, a tax of 3 cents per gallon."

That exempts these costly table waters as Mr. McCoy says——

Senator MCCUMBER. Let us have a little explanation of this—

"Upon all still drinks, containing less than one-half of 1 per cent of alcohol by volume, intended for consumption as beverages in the form in which sold (except natural or artificial mineral and table waters and pure apple cider)."

Certainly you do not need to put an exception on natural or artificial mineral and table waters. They do not contain any alcohol, do they?

Dr. ADAMS. That is a still drink. They are taxed under the present law at a low tax.

Senator MCCUMBER. But this is upon all still drinks containing alcohol. Then you say, "except natural or artificial mineral and table waters." Inasmuch as they do not contain any alcohol, why should they be an exception to something that does contain alcohol?

Dr. ADAMS. The comma is after the word "drinks," containing less than one-half of 1 per cent of alcohol by volume. The general phrase is applicable to only alcoholic drinks. Other still drinks are also taxed. That means that if it has any alcohol it must have less than one-half of 1 per cent; but still drinks have less than

that, and are also taxed. If you intend to except mineral waters, you better say so. However, there is a little grammatical redundancy there.

Senator WATSON. Why not say "on all still drinks except artificial or mineral table waters"?

Senator MCCUMBER. There is an assumption in there that these artificial mineral and table waters contain alcohol.

Dr. ADAMS. Many of them do. For instance, cider. Many of those fruit juices contain some little alcohol.

The CHAIRMAN. What is the definition of a still drink?

Senator MCLEAN. One that does not come from a still.

Dr. ADAMS. It is not carbonated and has no "kick" to it.

The CHAIRMAN. Then why is not a fruit juice a still drink?

Dr. ADAMS. It is. A fruit juice is here in this provision intended to be consumed just as sold. Most fruit juices are intended to be diluted a little; so the rates are a little lower and go into subdivision (b).

The CHAIRMAN. I know that is true, and I was wondering why it was made the subject of a separate subdivision

Dr. ADAMS. There are other things, too

The CHAIRMAN. Such as what?

Dr. ADAMS. Cider would be one.

The CHAIRMAN. That is a fruit juice.

Senator MCCUMBER. When you speak of still drinks you mean those that go through a still process?

Dr. ADAMS. No, sir; it does not mean that.

Senator MCCUMBER. What do you mean?

Dr. ADAMS. They mean nonsparkling.

Senator MCCUMBER. Unfermented?

Dr. ADAMS. Not carbonated.

Senator MCCUMBER. Why not use a word, then, that expresses it?

Dr. ADAMS. That is an old term that has been used a long while, Senator.

The CHAIRMAN. I would like to be shown the difference between unfermented fruit juice which is not carbonated and a still drink.

Dr. ADAMS. The distinction in those two sections, (b) and (c), is that one of them is intended to be diluted when consumed and the other is intended to be consumed exactly as sold.

The CHAIRMAN. Since I have been sick I have drunk considerable grape juice, and I do not dilute it.

Dr. ADAMS. The ordinary person is advised that it may be diluted. People drink the ordinary loganberry juice, for instance. They drink it both ways. More often they put a little water with it.

Senator MCCUMBER. From one-third to one-half.

Dr. ADAMS. That is the directions.

The CHAIRMAN. Is that the reason for the two different paragraphs?

Dr. ADAMS. Senator, you have got to take account of the concentration. You can get it exceedingly highly concentrated. Coco Cola is sold in two forms. Some of it is bottled to be drunk as sold. You have got to have a heavier tax on the concentrated, in order to be fair. That is the point. The amount of concentration determines the tax.

The CHAIRMAN. Now you are making it a little plainer. It is the amount of the concentration?

Dr. ADAMS. It is the amount of the concentration. I do not mean to say that I indorse all this. There are some things here that I do not agree on personally, but that is the underlying thought. Subdivision (d):

"Upon all finished or fountain sirups of the kinds used in manufacturing, compounding, or mixing drinks commonly known as soft drinks, sold by the manufacturer, producer, or importer, a tax of 10 cents per gallon; except that where any person manufacturing carbonated beverages or conducting a soda fountain, ice cream parlor, or other similar place of business manufactures any sirups of the kinds described in this subdivision, there shall be levied, assessed, collected, and paid on each gallon manufactured and used in the preparation of soft drinks a tax of 10 cents per gallon; and except that the taxes imposed by this subdivision shall not apply to finished or fountain sirups sold for use in the manufacture of a beverage subject to tax under subdivision (a) or (c)."

Reading further:

"(e) Upon all carbonic-acid gas sold by the manufacturer, producer, or importer to a manufacturer of any carbonated beverages, or to any person conducting a soda fountain, ice-cream parlor, or other similar place of business, and upon all carbonic,

acid gas used by the manufacturer, producer, or importer thereof in the preparation of soft drinks, a tax of 5 cents per pound."

You notice that those taxes are all on the producers, so that they do not touch the consumer, such as in the present soft-drinks tax.

The CHAIRMAN. Going back again, why was the tax of 4 cents a gallon imposed instead of the old ad valorem tax?

Dr. ADAMS. That has largely a political history, of a kind. The present ad valorem tax is being evaded rather widely by the device of the subsidiary corporation. A producer who would sell goods would sell at $1.75, $2, or $2.20, and the tax would be very high. Instead of doing that he sells to a subsidiary corporation at almost the bare cost of production. Consequently, the ad valorem tax is quite low. Then the subsidiary corporation sells; and as the tax is on the producer only, the tax is measured by the first price——

Senator CURTIS. The second man gets a big price and pays no tax?

Dr. ADAMS. The specific rate is a much more effective device than the ad valorem rate and it was recommended by the department originally that they change from the ad valorem to the specific tax for that reason. The specific tax, over in the House, went through a series of very kaleidoscopic changes. It went to 12 cents, to 15 cents, and, under representations from the industry, they reduced it to 10 cents, and finally to 4 cents.

There was a license tax which was calculated to yield, Mr. McCoy thought, about $10,000,000 a year. They took that off finally, also.

Senator SIMMONS. How about the tax on bottled drinks?

Dr. ADAMS. The bottle drink has a tax of 2 cents a gallon in paragraph 2—pop, and all that sort of stuff.

Senator LA FOLLETTE. You said, Doctor, that you had some views that were not in accord with the principle expressed in this paragraph?

Dr. ADAMS. The principal thing is the point mentioned by Mr. McCoy. If you can, and if you think it worth while, somehow isolate the costly table waters. There is no reason why they should be exempted. The difficulty, and the reason behind that exception is that it also applies to common table waters sold around the streets in some towns where the ordinary drinking water is not good.

Senator LA FOLLETTE. Is that carbonated?

Dr. ADAMS. No, sir; it is not. It is a still drink, you see, in paragraph (c). That makes taxation of ordinary water in some places where everybody needs water. That is the trouble. Except for that, the costly table waters could be taxed——

Senator WATSON. Such as Poland Springs water?

Dr. ADAMS. Yes, sir; and those that you buy at high prices. They are susceptible of taxation.

Senator CURTIS. Could you not draw a provision putting in an exception that would eliminate it?

Dr. ADAMS. I think if the committee wanted it done we could put an exception in and say, "artificial mineral or table waters selling for more than" a certain price.

The CHAIRMAN. This is becoming a very obscure part of the bill to me. It began as a very innocent thing with grape juice and other harmless decoctions.

I would like to ask Mr. McCoy what the change to the gallon basis amounts to.

Mr. MCCOY. There was great difficulty in that ad valorem duty. For example, take a concern manufacturing in St. Louis and selling in Boston. The selling price would include the cost of manufacture, the cost of the container, the cost of the freight all the way to Boston, and the selling costs there, and the tax was 15 per cent on that entire volume. The business in the country protested very much against that 15 per cent tax, and finally the Treasury Department advised them to sell at their home place to a subsidiary. So they simply followed the Treasury's advice and sold to a subsidiary in their home place.

Some concerns, however, overdid that. They manufactured a cereal beverage in a tank passed from a pipe to another tank, and in passage it was sold. So the department lost quite a lot of duty there.

On the other hand, some of them have bottled beverages and sold them in bottles and through their subsidiaries. That was fairer.

As to the cost of this cereal beverage, it varies very much. Some of them are making it for $5 a barrel, while the Anheuser-Busch books show it cost them about $9 a barrel to make a barrel of 31 gallons.

Senator WATSON. Such as Bevo?

Mr. MCCOY. A cereal beverage. They have been losing just about the amount of the duty paid since they began manufacturing this drink.

The CHAIRMAN. Is it much more expensive to make grape juice or less expensive?

Mr. MCCOY. Grape juice is hardly in the same category. Grape juice is very much of a food and health product. That probably should receive special treatment. But

it costs very much more to make than sarsaparilla or ginger ale or any of those common drinks sold at the fountains.

The CHAIRMAN. It costs more to make them?

Mr. McCOY. It costs much more to make a cereal beverage than it costs to make ginger ale or sarsaparilla or any of those soda-fountain drinks.

Senator MCCUMBER. Can you make loganberry juice for from four to nine dollars per barrel?

Mr. McCOY. I imagine so, sir.

Senator MCCUMBER. Could a manufacturer make it at that price?

Mr. McCOY. I imagine it would not cost very much more. It is a simple process to squeeze out the juice.

Senator MCCUMBER. Yes; but it takes a lot of berries to make a barrel.

Senator SMOOT. And they put a lot of water in.

The CHAIRMAN. I have given up trying to fully understand it myself.

Senator SIMMONS. Mr. McCoy, under this bill are bottlers exempt from tax?

Mr. McCOY. There is no tax on them. It is taxed in the manufacture.

Senator SIMMONS. There is no tax on the fountain man and no tax on the bottlers?

Mr. McCOY. The bottler who bottles and sells the beverage is taxed. It is a tax on the manufacture. It is a tax on the first sale of the product. After that it is not taxed.

Senator SIMMONS. In other words, if a bottler buys Coco-Cola sirup and makes it into Coca-Cola and puts it in bottles, he is taxed, is he?

Mr. McCOY. He is only taxed on the cabonic acid gas that goes into it.

Senator SIMMONS. He does not pay the bottler's tax?

Mr. McCOY. No, sir.

Dr. ADAMS. In lines 8 and 9 of subdivision (b) the bottler is taken care of. It reads: "Manufactured, compounded, or mixed by the use of concentrate, essence, or extract."

I have always understood that the 2 cents was imposed upon the bottler if he manufactured any kind of drink at all by the use of a concentrate, essence, or extract, instead of a finished or fountain sirup. If he uses a sirup, the tax is on the manufacturer of the sirup.

Mr. McCOY. He pays a 10 cents a gallon tax on Coca Cola and 5 cents a pound on the carbonic acid gas.

Senator SMOOT. I suppose that 90 per cent of all of that class of drinks that are sold at circuses in little bottles comes from concentrated essence or extract, and will pay 2 cents?

Dr. ADAMS. It will not be taxed in the bottle form to the purchaser.

Senator SMOOT. No; 2 cents a gallon.

Senator REED. What is imposed on beverages such as Bevo?

Dr. ADAMS. Four cents.

Senator REED. What is it on water?

Dr. ADAMS. Nothing on water.

Senator REED. I do not suppose we want to stop to argue it, but the fact about the matter is this, that in drinks that are made now, such as Bevo, from malt, and are absolutely nonintoxicating and are supposed to be very healthful, the ingredients all have to be bought except the water. A man goes out and takes common water from a spring somewhere and shoots a little gas into it and sends it out for nothing. I think that ought to be looked into when we get to it, Mr. Chairman.

Senator WATSON. We were discussing that a moment ago, before you came in, Senator.

Senator SIMMONS. Near beer is taxed 4 cents, and it is expensive to make. Some of these other things that are inexpensive to make, and that sell for practically as much, are taxed only 2 or 3 cents.

Senator REED. I want to ask you, Mr. Chairman, if when we get through with this there are going to be any hearings at all or any permission to anybody to come in to be heard in connection with this matter.

The CHAIRMAN. The committee up to date has determined not to have any open hearings, or any hearings, on the revenue bill. That does not mean that individual members of the committee can not be seen by taxpayers. That is their privilege. In some extraordinary case, I imagine, the committee might consent to confer with some prominent taxpayer or some taxpayer who knows what he is talking about.

Senator REED. This is a matter of such importance to one or two people in my State that I made that inquiry.

The CHAIRMAN. You mean this beverage matter?

Senator REED. Yes.

The CHAIRMAN. It is of very great importance, Senator. There is more correspondence in connection with it, perhaps, than in connection with almost any other part of the bill.

Senator CURTIS. We heard your people last spring, Mr. Reed. We heard all the loganberry and grape-juice and cider people.

The CHAIRMAN. We had hearings of witnesses from here to Oregon on this subject.

Senator REED. I do not want to halt the committee to discuss this now. I suppose briefs would be examined anyway?

The CHAIRMAN. Of course. We want them.

Senator WATSON. At the beginning of these sessions this committee had six weeks of hearings. Witnesses came from St. Louis and other places and presented their views on the tax on soft drinks.

Senator REED. I did not know there had been any hearings on the matter.

Senator WATSON. Yes. I have copies of those hearings in my office, and I suppose every other Senator has.

The CHAIRMAN. Senator McNary has been here before the committee in connection with it, and also the Senators representing grape States. The brewers have all been heard.

Senator REED. Go on, Mr. Chairman. I will not interrupt you any further.

The CHAIRMAN. In addition to that, the committee is to a certain extent pledged to report this bill when Congress meets, if possible.

Dr. ADAMS. Page 199, subdivision (b). That is a mere regulative provision, reading as follows:

"Each person required to pay any tax imposed by section 628 shall procure and keep posted a certificate of registry in accordance with regulations to be prescribed by the commissioner, with the approval of the Secretary. Any person who fails to register or keep posted any certificate of registry in accordance with such regulations, shall be subject to a penalty of not more than $1,000 for each such offense."

There is, as I recall, no amendment to Title VII, the tobacco tax, and we pass to page 209, Title VIII, tax on admissions and dues.

Senator REED. You struck out the old law, and this is a substitute?

Dr. ADAMS. Yes, sir.

The CHAIRMAN. You say there is no change in the tobacco taxes?

Dr. ADAMS. No change in tobacco at all, sir.

The CHAIRMAN. I thought there was one change. I have forgotten what it was. It is not important.

Senator WATSON. I thought they put a little additional tax on cigarettes.

Senator SMOOT. They were talking about it.

The CHAIRMAN. Mr. McCoy, or Dr. Adams, have you ever considered whether cigarettes particularly could stand a fairly larger amount of taxation?

Dr. ADAMS. That is a pretty nice question, Mr. Chairman. The department has at times in the past suggested an additional tax from $3 to $5 a thousand. The cigarette consumption, after some falling off, is now increasing again. But the tax is pretty high as it stands. It will probably average 25 per cent or more on the retail price. But if you need more revenue, that is an available source.

The CHAIRMAN. In your opinion cigarettes would stand a slight increase in taxation?

Dr. ADAMS. That all depends, Senator, upon whether you want additional revenue.

The CHAIRMAN. Well, we do, of course.

Dr. ADAMS. I can not answer that—I do not want to answer it very certainly, for this reason: The cigarette consumption fell off. The actual withdrawals this year, 1921, for sale are less than before; and if it is falling off it ought not to be further taxed. In recent months it has been increasing, has it not, Mr. McCoy?

Mr. MCCOY. But it has not got back to where it was.

Dr. ADAMS. I do not think, unless you need revenue, that there ought to be a higher tax. If you do need revenue that is a source that you can well consider.

The CHAIRMAN. Is there any other form of tobacco that could have the tax increased upon it?

Dr. ADAMS. I think the cigarettes are the most available. I think that an increase in tax on cigars would cut it off more.

The CHAIRMAN. How about the ordinary smoking tobacco by the bag or by the pound?

Dr. ADAMS. I do not think it should be increased, for the same reason. The tobacco taxes are very near the collection point. You are getting a big revenue now—$265,000,000 or so a year.

Senator WATSON. You will place the tax at a point where an additional tax will prevent use.

Senator SMOOT. I was afraid that the present tax on cigarrettes was so high that we could not collect the amount that we have collected. It was so demonstrated for a while.

Dr. ADAMS. In Title VIII, admissions and dues, there is a section stricken out at the bottom of page 209. That subdivision imposed a tax on free admissions and half admissions, which proved troublesome and difficult to check up. The department recognized that where admission is not charged no tax should be imposed.

There is a slight change in line 18, page 210, reading, "and subject to the penalties and interest." It was thought wise to put that in. The same change is made in line 1, page 211.

The CHAIRMAN. My recollection is that it was endeavored to take care of admissions and dues in the present law, and it got into endless confusion and was not properly framed.

Dr. ADAMS. That is working on the whole, satisfactorily.

The CHAIRMAN. Now, you have fixed it?

Dr. ADAMS. Beginning in the very last line of page 211 there are some real changes made in the exemptions in this tax. The first subdivision deals with exemptions, and there are inserted the words "or societies or organizations conducted for the sole purpose of maintaining symphony orchestras, and receiving substantial support from voluntary contributions."

And, coming down to line 9, retaining the present law and adding to it—"or of improving any city, town, village, or other municipality—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual; * * * or (C) exclusively to the benefit of persons who have served in such forces and are in need."

Senator REED. I want to ask a question about the construction of that section.

Here is a hospital, we will say. Along comes a promoter who agrees to get up an entertainment for the benefit of these gentlemen. First you take out the expenses, and include in the expenses probably 25 per cent for himself. The result is that generally the soldier or the eleemosynary institution itself gets practically nothing.

I am wondering if that section would be open to that construction.

Mr. ADAMS. It would not. This starts out, Senator, on page 211, providing:

"No tax shall be levied under this title in respect to (1) any admissions all the proceeds of which inure (A) exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions, or of improving any city, town, village, or other municipality—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual; or (B) exclusively to the benefit of persons in the military or naval forces of the United States; or (C) exclusively to the benefit of persons who have served in such forces and are in need."

Senator SMOOT. Has this ever come to your attention?

Dr. ADAMS. We do not care anything about this. It was introduced by Representative Mills, of New York, and accepted by the House.

Senator MCCUMBER. I can not see any great harm in it.

Dr. ADAMS. No; it is for needy soldiers.

Senator CALDER. Doctor, every year we have police games in New York.

Dr. ADAMS. This will take care of them.

Senator CALDER. Will you show me that provision?

Dr. ADAMS. The provision comes in in the change. If you will read lines 4 to 9, the old verbiage was as follows: "None of the profits of which are distributed to members of such organizations, or exclusively to the benefit of persons in the military or naval forces of the United States, or admissions to agricultural fairs none of the profits of which are distributed to stockholders or members of the association conducting the same."

That has been changed to the language, in general: "if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

That language is identical with the exemption provisions of the income tax. By a long series of holdings unbroken in the department, police entertainments of the kind you speak of and police organizations of the kind you speak of have been exempted under the income tax. They were not exempted by ruling under the old language of the admissions tax. By taking over that language from the income tax, which has had long and extensive interpretation, they will go out under that, unquestionably.

Senator CALDER. The proceeds are used for pension funds and hospitals.

Dr. ADAMS. Yes, sir. It introduced a nice legal question, and the department held that they did not go out under the language of the admissions tax, and in order to

get one identical set of words to cover both cases, because the thought is the same, they brought over the old definition which has had so much interpretation by the income tax department.

Senator SUTHERLAND. A few days ago we had a big carnival in this city for the benefit of some organization. Would that cover a case such as this, Doctor? They probably got under the protection of some charitable organization in order to get a location on Government property here and get backing for their own purposes.

Dr. ADAMS. We do not hold that where a carnival company takes a large proportion of the proceeds or "rake-off" the proceeds inure exclusively to charity. Common sense is used, or we try to use it, in the interpretation. The exemption is not declared off by reason of some small expense; and if it is the case that the expenses are the major portion of the proceeds, then we hold that the proceeds are not inuring to the benefit of charity.

Senator WALSH. How are you able to check that up?

Dr. ADAMS. The officers are very careful on that, as those things go. They try to keep a check on tickets in the theaters, and find where they left off selling tickets and where they began again. There has been evasion in the past and some evasion still, but, on the whole, the administration of this tax has been brought to the point where it is satisfactory, as taxes go, not as satisfactory as some other taxes.

Senator LA FOLLETTE. On what principle are symphony orchestras exempted from taxation?

Dr. ADAMS. On the ground, I suppose, that they are promoting art and education, and that sort of thing.

Senator SMOOT. I think there are three of them that are sustained by contributions, one in New York, one in Boston, and one in Chicago. They are sustained through contributions made for the purpose of gathering together the best talent there is in the United States and showing at a loss through the different cities wherever they go. That is why they were put in the original bill.

Dr. ADAMS. Line 15, page 212, "or (2) any admissions to agricultural fairs none of the profits of which are distributed to stockholders or members of the association conducting the same, or admissions to any exhibit, entertainment, or other pay feature conducted by such association as part of any such fair, if the proceeds therefrom are used exclusively for the maintenance and operation of such agricultural fairs."

On lines 4, 5, and 6 of page 213, a change has been made. I will read that:

"(d) The price (exclusive of the tax to be paid by the person paying for admission) at which every admission ticket or card is sold shall be conspicuously and indelibly printed, stamped, or written on the face or back of that part of the ticket which is to be taken up by the management of the theater, opera, or other place of amusement, together with the name of the vendor, if sold other than at the ticket office of the theater, opera, or other place of amusement."

That is in order to make the administration better. There is a change in lines 12 and 13 on page 214. That has been made to correspond with the exemption when the admission is free.

Lines 19 and 20, page 214, "and subject to the same penalties and interest." That is another change in the administration, and simply to state what seems to be the law.

Title IX, dealing with miscellaneous excise taxes, has been greatly changed in parts. The change in lines 11, 12, and 13, is largely for clarification and introduces no substantive change in the present law. The present law is a little obscure there. "Tires, inner tubes, parts, or accessories for automobile trucks, automobile wagons, other automobiles, or motor cycles," and so on.

Senator REED. Now, you propose to levy a tax on the automobile when it is bought and thereafter to levy a tax on every accessory?

Dr. ADAMS. That is already levied. This is to confirm an exemption which is doubtful, Senator, in the case of a person selling parts of parts. It was doubtful, and we wanted to make it perfectly clear that the tax is not to be levied upon a part of an automobile part, and also upon the completed part. The tax is already levied on the parts.

Senator REED. Where is the clause clarifying them? It is not here; it is some other place.

Dr. ADAMS. No; it is right here in these words: "Tires, inner tubes, parts, or accessories for automobile trucks, automobile wagons, other automobiles, or motor cycles sold to any person other than a manufacturer or producer of any of the articles"——

Senator MCCUMBER. It is a tax on the consumer.

Senator REED. Yes; it is a consumption tax.

Dr. ADAMS. Yes; if the part is sold separately it is.

Senator REED. That brings me to the point I was trying to get at. Is it proposed to put a sales tax in this bill?

Senator SMOOT. If I can get votes enough I will put it in.
Senator REED. But it is not here now?
Senator SMOOT. No.
The CHAIRMAN. Is it not offered yet.
Senator SMOOT. I do not want to offer it until this bill is complete.
Senator REED. Here is the sales tax inserted in here on parts and automobiles. It seems to me that it does not belong in a bill framed along these lines.
Dr. ADAMS. It is only imposed upon the producer or importer. It does not apply to the dealer—only the producer and importer of these articles.
Senator WATSON. There is no general principle of taxation involved in this bill, Senator. It is just grabbing out for revenue wherever they can get it. It is not supposed to be a systematized law.
Senator REED. Why should you levy the tax on parts of an automobile if you do not levy it on parts of a wagon?
The CHAIRMAN. Senator Watson has struck it. There is no logic or science in this part of the revenue bill. They are just endeavoring to collect money wherever it seems convenient.
Dr. ADAMS. In line 18 the words "player pianos" have been inserted. Piano players have always been taxed, and there is some little doubt as to whether player pianos have also been taxed. I thought we had that cleared up by inserting the words "player pianos."
The CHAIRMAN. I thought we had quite a discussion over player pianos at the time of the passage of the last bill.
Dr. ADAMS. There has been quite a discussion as to whether you could tax pianos or not. There has been no particular discussion of this small change. The question is whether player pianos are also taxed, and we have held them taxable as being pianos, but we would rather have it cleared up.
Beginning on line 22, page 215, is the tax on sporting goods. Certain classes of sporting goods have been exempted, and these are shown in the items stricken out—"skates, snowshoes, skis, toboggans, baseball bats, gloves, masks, protectors, shoes and uniforms, football helmets, harness and goals, basket ball goods, and uniforms."
Senator REED. Why should they be stricken out?
Dr. ADAMS. That is the House amendment. I suppose it is due to the fact that baseball is a popular game.
Senator SMOOT. On toy balls you would have to pay a tax. Every kind of ball except baseballs and basket balls will be taxed.
Dr. ADAMS. Skis and toboggans were not taxed, I think, on account of the fact that they were articles of necessity in the north country.
Senator WATSON. How much tax do we get on the articles enumerated in subdivision 4?
Dr. ADAMS. We got eleven and a half million dollars last year.
Senator LA FOLLETTE. What is the difference between "piano players" and "player pianos"?
Senator SMOOT. A player piano is a complete instrument with the automatic device built on it.
Dr. ADAMS. I think there is very little doubt that those are taxable. We have always held them to be taxable.
Senator MCCUMBER. A piano player was something that could be taxed, but the player piano is one in which the instrument that is automatic is part of the piano itself.
Dr. ADAMS. Yes.
Senator SMOOT. The instrument is complete in itself.
Dr. ADAMS. In line 14, page 216, there has been added to the tax on cameras "and lenses for such cameras," because the lenses in many cameras constitute the most important part of the cameras, and are sometimes sold separately. If the camera is taxed there is no reason why the lense should not be also taxed.
The sporting goods rates have been reduced from 10 to 5 per cent.
The tax on portable electric fans has been stricken out.
The CHAIRMAN. Why is there that limitation on the weight of the camera?
Dr. ADAMS. The heavy camera was supposed originally to be used purely for commercial purposes. It is not used for taking pictures, but it is used in reproducing drawings. That was exempted on that ground. Whether such action was right or not I do not know, but that was the reason for it.
Senator SIMMONS. Doctor, why was the duty on sporting goods reduced from 10 to 5 per cent?
Dr. ADAMS. Senator, that was a question of policy decided by the House alone. I do not know what they thought; I can not tell you that.

By mistake I passed over a similar reduction in the candy tax from 5 to 3 per cent. appearing in line 17, page 216.

Senator WALSH. What is the yield from candy?

Dr. ADAMS. Twenty-odd millions a year, I think.

The CHAIRMAN. I want to purge my conscience before the committee. Mr. Beaman reminds me that I have put in the restriction on the weight of the camera. I have forgotten now why I did it.

Dr. ADAMS. I never was quite certain that it was sound, but it went in.

Senator REED. Do you know anybody that does not think this tax is excessive? I do not.

Dr. ADAMS. I think there have been no changes in these other taxes.

Senator WALSH. Why were portable electric fans exempted?

Dr. ADAMS. As being an article of necessity, in the hot weather particularly.

The tax on fur has been reduced from 10 per cent to 5 per cent.

The CHAIRMAN. Just a moment. What was the reduction in the rate on candy?

Dr. ADAMS. It was reduced from 5 to 3 per cent.

The CHAIRMAN. Why?

Dr. ADAMS. They sent in a great many exhibits of candy which the committee greatly enjoyed. I do not know whether that had anything to do with it or not.

The CHAIRMAN. That is what I am told; that the committee was eating candy at the time the reduction was made, and I want to take the opportunity to have the rate put back.

The CHAIRMAN. Mr. McCoy, how much will that reduction in the rate on candy take off of the revenues?

Mr. McCOY. From ten to eleven million dollars.

Senator SIMMONS. How much will the reduction on sporting articles affect the revenue?

Mr. McCOY. About $2,000,000.

Senator SIMMONS. What does this reduction on furs amount to?

Mr. McCOY. About $5,000,000. In 1920 they collected almost twice as much as they did in 1921.

The CHAIRMAN. I think the fur people have a special case. St. Louis is the fur market of the world.

Senator SIMMONS. I would like to hear the reason for it.

The CHAIRMAN. The reason was, as I recall it, that St. Louis instead of London is the fur market of the world, and the imposition of this tax interfered with that international situation. Was not that it, Mr. McCoy?

Mr. McCOY. Yes, sir.

Senator SIMMONS. What international situation?

The CHAIRMAN. We could not maintain St. Louis as the market place of the world for selling raw furs. Their annual auction there is a world event.

Dr. ADAMS. I think it is only articles made of fur. Raw furs are not taxable. The fur manufacturers protested most.

Senator DILLINGHAM. Unless you charge clothing in general, why should you charge clothing made of fur?

Senator SMOOT. A great deal of it is rabbit fur.

Senator SIMMONS. That might be an argument for taking it all off, but it is not an argument for cutting it in two.

Dr. ADAMS. Regarding the articles which are reduced from 10 to 5 per cent, the bill says:

"This paragraph shall apply to all such articles which are commonly or commercially known as fur, except raw, dressed, or dyed skins of sheep, goats, calves, cattle, or horses, and except coats sold at less than $30, of which such skins are the component materials of chief value."

That is to get out the farmers' sheepskin coats and the like.

Senator MCCUMBER. And there you are making a distinction between one that costs $30 and one that costs $30.50.

Dr. ADAMS. That is the wholesale price.

Senator MCCUMBER. I know, but we ought to try and get rid of that extra levy upon what people wear.

Senator REED. I do not quite understand you, Doctor. Subdivision 18 says:

"Articles made of fur or on the hide or pelt, or of which any such fur is the component material of chief value (except these sold to a manufacturer for use in the manufacture of fur articles), 5 per centum. This paragraph shall apply to all such articles which are commonly or commercially known as fur, except raw, dressed, or dyed skins of sheep, goats, calves, cattle, or horses."

That does not take out the raw fur that is sold.

Dr. ADAMS. I think not.

Senator REED. I think if you are going to consider that question about the injury to the great market of the world, in striking it out there might be something in it, but raw furs are not out in this paragraph.

The CHAIRMAN. Your colleague has this very much at heart and has requested the committee to give him an opportunity to appear at our executive session. I think it is a matter of considerable importance, and it might be well for you to look into it.

Senator REED. Yes; I shall do so.

Senator SUTHERLAND. This refers only to manufactured furs.

The CHAIRMAN. It reaches them indirectly in some way. I do not know just how it is.

Senator SIMMONS. That amendment would seem to include raw furs.

Senator CURTIS. The Treasury Department can add a few words there to clarify it.

Dr. ADAMS. If you will tell us what you want done we will change the phraseology.

In line 7, page 218, the tax on yachts and motor boats has been reduced from 10 to 5 per cent.

In line 8 of the same page the 3 per cent tax on toilet soaps and toilet soap powders has been abolished.

Senator REED. Let us see why we are taking the tax off yachts and motor boats. How much does it amount to?

Dr. ADAMS. $270,000 a year.

Senator REED. Let us take it off the yachts and leave it on the motor boats.

Dr. ADAMS. Senator, you have two taxes on yachts and pleasure boats. One is a tax when it is sold. This is that tax. Later on you have a license tax for its use during the year. I think there is some occasion for this action, because the two taxes together were rather excessive.

Senator REED. Anybody that can own a yacht can pay a tax.

Dr. ADAMS. Well, it is beyond the collection point. That is the reason it was changed. That impressed me as being fairly sound.

Dr. ADAMS. On yachts or motor boats sold by the producer or consumer they were evading that tax until they became second hand and then they were selling them second hand by the dealers who are subject to this tax.

Senator REED. The motor boat is a different question. The motor boat, for instance, is used by fishermen now to a very great extent.

Senator SMOOT. But this applies only to those not designed for trade.

Senator REED. The motor boat that the fisherman uses and the motor boat that the ordinary fellow uses are about alike. When it becomes a question of exempting yachts I am going to vote against it.

Dr. ADAMS. In line, 8, page 218, the tax of 3 per cent on toilet soaps and toilet soap powders is abolished.

Senator SIMMONS. How much will we lose by taking that tax off toilet soaps?

The CHAIRMAN. Dr. Adams, I think if we could get as we go along what we are losing in wiping out these things it would be well.

Dr. ADAMS. I have a statement that I am going to present to-morrow covering such items.

The CHAIRMAN. Well, could you not tell us as you go along?

Dr. ADAMS. Mr. McCoy informs me that on toilet soaps and toilet soap powders we will lose two and a quarter million dollars.

Senator CURTIS. The collections last year amounted to $1,900,000 and this year to $1,200,000.

Dr. ADAMS. Gentlemen, you will recall that in section 904 you have the so-called luxury taxes on articles of clothing that sold beyond a certain price. Most of those have been repealed, but a few of them have been brought over from section 904, by which section they were imposed upon the retail purchaser and put upon the producer or manufacturer. These are the articles that have been retained.

Senator REED. But paid by the consumer just the same.

Dr. ADAMS (reading): "Carpets and rugs, including fiber, if sold for more than $3.50 a square yard, 5 per centum; trunks, if sold for more than $30, 5 per centum; valises, traveling bags, suit cases, hatboxes used by travelers, and fitted toilet cases, if sold for more than $15, 5 per centum."

Senator MCCUMBER. That means sold by the wholesale?

Dr. ADAMS. Sold by the manufacturer.

Senator REED. Let me ask this question—it fits in with the suggestion of Senator McCumber a while ago: Why is it that that tax is not levied on the excess above the amount named? For instance, "trunks, if sold for more than $30, 5 per centum." Why is the tax not levied on the excess above $30?

Senator SMOOT. That is what it is.

Senator REED. No; it is 5 per cent on the entire amount.

Senator MCCUMBER. You can not buy a rug in the market that is fit to be used at a price of $3.50 a square yard. Rugs run in price away above that. You put a tax on practically every rug that is bought, even the cheapest kind, by the distinction you have made. The rug which the manufacturer sells for $3.50 will sell, for, perhaps, $8 or $9 a yard.

Dr. ADAMS. I would not like to be charged with the parentage of this section.

Senator SMOOT. Here is a trunk that sells for $30, and if one sells for $35, then they have to pay $1.75. It is perfectly absurd.

The CHAIRMAN. Dr. Adams, have you ever reflected as to whether the Government is the gainer by imposing a tax on the manufacturer instead of on the purchaser?

Dr. ADAMS. I think it is altogether a more convenient and less irritating method of collecting taxes.

The CHAIRMAN. As Senator Smoot just now suggested, can they not in some hidden way increase the price of a rug on the theory of the tax, and the manufacturer make a profit on that article to which he is not entitled?

Dr. ADAMS. That is believed by a good many people.

Senator SMOOT. Is it not true?

The CHAIRMAN. If he has to pay a tax amounting to 5 per cent, he will put 10 per cent on the price and pocket the difference, thus making a profit out of the tax.

Dr. ADAMS. Senator, my own feeling on that is that it depends wholly upon the state of the market. I feel that there are times when they can not pass the tax along at all, and there are other times when they can pass all of the tax.

The CHAIRMAN. But is not the general rule and the weight of the tendency in favor of the manufacturer getting a rake-off?

Dr. ADAMS. In the long run the tax is passed on. In the short run anything may happen. The musical-instrument people say that they are not able to shift their tax in the present condition of the market.

The CHAIRMAN. That is because they are paid in installments.

Senator WATSON. Is altogether a question of whether you are selling in a buyers' market or a sellers' market.

The CHAIRMAN. But musical instruments are all sold on installments and they have to pay the tax before the payments are completed.

Senator SMOOT. Answering your question direct, it is demonstrated beyond question of doubt that wherever a tax is imposed upon the manufacturer it is easier for the Government to collect it, and not only is it easier, but the Government collects more tax. For instance, when we had on the proprietary medicines a 2 per cent manufacturers' tax we collected more than we did when there was a rate of 5 per cent upon the retail price of those medicines.

The CHAIRMAN. Completing your argument, Senator Smoot, is not the consumer mulcted surreptitiously of the additional tax which the manufacturer pockets?

Senator SMOOT. I have not any more doubt of it than that I am living.

Senator REED. Senator, if you will recall, when we had the tariff bill up there were two or three witnesses here who discussed the question of the price that they would have to get for articles, and in every instance they added in the tariff. That is, they took the cost of the article when it arrived in this country; they added the tariff to the cost; then they added their profits to the aggregate, getting a profit, of course, upon the tax paid. Of course, they will do that here. They say if our profit is to be 25 per cent it is 25 per cent on our total investment, which includes the tax paid. So that every tax you levy back there on the manufacturer is going to be carried along, and they are going to try and get a profit on the aggregate investment. Of course, what Senator Watson says is true; if it is a buyer's market they can do one thing; if it is a seller's market they may do another.

Senator LA FOLLETTE. We had some very strong arguments made by men who spoke with some authority on that subject here when we were considering the sales tax bill. I think the weight of authority was against the possibility of passing the tax along to the consumer in most cases. It turns on this: If the people who produce the article that is to be taxed are in a position where they can fix prices, they fix prices just as high as the market will stand: as high as the purchasing power of the people will permit, and when you add a tax on top of that they are not able to take it out of the consumer. So, too, if you have a falling market you can not possibly collect the tax from the consumer. And the reason you have so many people here who wanted to get rid of the excess-profit tax, advocating its repeal, was because they could not pass it along. If they could pass it along they would not have been here advocating its repeal.

Senator REED. You can not pass the excess-profits tax along as easily as you can the other.

The CHAIRMAN. Senator La Follette, do I understand that you approve of this change?

Senator LA FOLLETTE. To what change do you refer, Mr. Chairman? I was speaking just generally.

The CHAIRMAN. The change putting the tax on the manufacturer instead of on the retailer. My mind is open on the subject, of course.

Senator LA FOLLETTE. Yes; I think that it has some advantages in the matter of the collection of the tax, to begin with, and in the inability to pass the tax along.

Dr. ADAMS. On page 219 there is an important change made in lines 1 to 5. There has been stricken out the existing provision, "That if any manufacturer, producer, or importer of any of the articles enumerated in this section customarily sells such articles both at wholesale and at retail, the tax in the case of any articles sold by him at retail shall be computed on the price for which like articles are sold by him at wholesale." That is a very difficult feature of the present law which gives rise to difficulties and evasions.

Senator WATSON. There is a big piano manufacturer in my State that is making a tremendous fuss against this thing.

Dr. ADAMS. The candy manufacturers have been the ones principally concerned.

Senator WATSON. Yes; and the candy manufacturers have made a demonstration against it.

Senator REED. If you take that out, how will you get your tax on the retail article?

Dr. ADAMS. You take it at the price at which he sells. He can afford to pay a tax on the retail price, particularly in many cases the tax is shifted, as you suggested. It is a nasty point in this whole tax anyhow from an administrative standpoint. You can find here in the city of Washington some that pay a tax on the wholesale basis and some that pay a tax on the retail basis. It makes it almost impossible to check them up accurately.

Section 901 is the administrative provision which has been practically incorporated, with some additions, with the amended section 901, beginning at line 24. It now reads:

"That if any person manufactures, produces, or imports any article enumerated in section 900 or leases or licenses for exhibition any positive motion picture film containing a picture ready for projection, and, where through any agreement, arrangement, or understanding, or otherwise, sells, leases, or licenses such article at less than the fair market price obtainable therefor, either (*a*) in such manner as directly or indirectly to benefit such person or any person directly or indirectly interested in the business of such person, or (*b*) with intent to cause such benefit, the amount for which such article is sold, leased, or licensed shall be taken to be the amount which would have been received from the sale, lease, or license of such article if sold, leased, or licensed at the fair market price."

Practically the only new thing in that is the portion dealing with the affiliated corporation; that is, a subsidiary.

The material stricken out on pages 221 and 222 are the luxury taxes.

The next change is in line 9 on page 224.

Senator LA FOLLETTE. On pages 221 and 222 we retain only the tax upon a portion of the list.

Dr. ADAMS. Just a few of them. The clothing articles were exempted.

Senator REED. It has been increased in some places. I notice here the amount you are taxed on is the amount in excess of $7.50 and in another place, where you name the article, the tax is levied upon the whole amount if it exceeds $4.

Dr. ADAMS. That is the wholesale price. Before that limit it was a retail limit. Now it is the producers' or manufacturers' limit.

In line 9, page 224, is a tax on jewelry, etc., and we are exempting eyeglasses and spectacles. That is the only change in the jewelry tax, as I recall.

Senator WALSH. Where is the language in this bill on page 218 that would indicate that the tax must be placed upon the manufacturer and the retailer?

Dr. ADAMS. That is not page 218. This tax is on the dealer; it is a jewelry tax. In the other instance it is on the producer and the importer.

Senator REED. How much do we lose by taking out eyeglasses and spectacles?

Mr. MCCOY. About $100,000.

Dr. ADAMS. On page 226, beginning at line 9, the present tax, which is approximately 4 per cent, on perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes, dentrifices, tooth pastes, aromatic cachous, toilet powders, or any similar substance, article, or preparation has been abolished and repealed.

Senator SIMMONS. How much do we lose in that case?

Dr. ADAMS. $6,000,000.

The CHAIRMAN. Why should that be abolished?

Senator LA FOLLETTE. Is that paragraph one under which we lose $6,000,000?

Dr. ADAMS. No; the two of them yield only about $3,000,000. If it were put on the the producers we would get a good deal more.

The CHAIRMAN. Are they not largely luxuries?

Dr. ADAMS. The Treasury Department thinks those taxes should be retained but put on the producer or importer so there would be a greater yield of money. The House thought they had better abolish them altogether. That is their decision.

The material on pages 227, 228, and 229 is for this purpose. It provides, in general, that if any of these articles newly taxed have been contracted to be sold at prices based on conditions existing before this new tax is imposed, the tax should be paid by the purchaser and not by the producer or dealer. It is a provision that we had in the law all along; that when you adopt a new tax on the producer or dealer if he has undertaken to sell at a price that did not contemplate this new tax, the dealer should pay the tax.

Senator SUTHERLAND. Would that be difficult of administration?

Dr. ADAMS. It occurs in only a few cases. We have similar provisions in the existing law, but they would not apply to these new taxes. They are not at all important, and I think you would indorse the purpose of them. There probably would be very few people affected because there are very few new taxes here.

The CHAIRMAN. You say that provision was in the original law?

Dr. ADAMS. Provisions of the same kind were in the original law.

Mr. BEAMAN. Except there is one new feature in here which never happened before, because you are for the first time reducing the tax, and there is the converse situation also taken care of; that is, where a man is contracting to sell there has been taken into consideration also the present tax.

Dr. ADAMS. We come now to the special taxes. There has been a good deal of doubt as to whether there was any limit on the time in which the capital stock tax imposed by section 1000 had to be assessed. That has been provided for on page 232 in subdivision (e) as follows:

"Taxes imposed by this section shall be assessed within 15 months of the due date of the return or date when the return is filed, except in the case of a false or fraudulent return, in which case an additional assessment shall be made within three years from the due date of the return. If, upon examination of any capital stock tax return made pursuant to this act, the revenue act of 1916, or the revenue act of 1916 as amended by the revenue act of 1917, it appears that an amount of capital stock tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any capital stock tax then due from the taxpayer under any other return and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after three years from the date when the return was due unless before the expiration of such three years a claim therefor is filed by the taxpayer."

I do not recall any other change in that title.

Mr. BEAMAN. There is a change on page 240.

Dr. ADAMS. Oh, yes. I said a moment ago that there was a sort of license tax on yachts and pleasure boats. That has been amended to take care of or exempt small boats, the exemption to take effect on January 1, 1922. That is found in lines 20 to 22, page 240. It provides:

"On and after January 1, 1922, the tax imposed by this section shall apply only in the case of yachts or boats over 5 net tons and over 32 feet in length."

There were a few such boats that were taxed under the existing law. They are now exempt.

Senator SIMMONS. So they are going to get them out.

Dr. ADAMS. They are going to get them out, exempt them.

Senator SUTHERLAND. Those are small boats?

Dr. ADAMS. Yes.

In the stamp taxes I think there has been no change made, except on page 256, lines 23 to 25. This is a stamp tax on bonds of indemnity and surety, and a tax which corresponds to the insurance tax was put here at the request of the insurance companies concerned and because the other insurance taxes were abolished this new stamp tax was abolished as it was designed to go along with the insurance tax payable in this instance by means of stamp. This is stricken out:

"That where a premium is charged for the issuance, execution, renewal, or continuance of such bond the tax shall be one cent on each dollar or fractional part thereof of the premium charged."

Senator REED. How much will we lose by that?

Dr. ADAMS. Senator, I do not know that it is possible to isolate that. It may be five or six hundred thousand dollars possibly. I do not know that we can tell you very intelligently how much it will be. You abolish the insurance tax. You have a tax of 1 per cent on insurance premiums. That is collected from the companies. Where this insurance bond is paid for annually by means of the premium, that particular tax was put in the stamp form, and when the other was abolished this also was taken off.

Senator SMOOT. The people at Baltimore were the ones that complained of it before, were they not?

Dr. ADAMS. There were other people that asked, as a matter of administrative form, that it be placed in stamp form.

Senator REED. How much will we lose by these changes?

Dr. ADAMS. On the total insurance tax about $19,000,000 a year.

Senator CURTIS. This statement says there will be a gain of $570,000. The tax collected in 1918 was $18,421,000, and that collected in 1921 $18,852,000.

Dr. ADAMS. Those are all insurance taxes. They have been abolished and there are about nineteen millions of them. But a new scheme of income taxation has been imposed which may collect a little more tax. My guess would be that the repeal of the insurance tax would cost sixteen or seventeen millions a year. They yield now $19,000,000. They have been abolished, but some other changes, I think, will reduce that loss a little. Mr. McCoy, you are figuring on a loss of $19,000,000, are you not?

Mr. MCCOY. From nineteen to twenty million dollars.

Senator SMOOT. A net loss of $20,000,000?

Dr. ADAMS. Yes; with the abolition of this special tax on insurance.

There are no changes in the miscellaneous tax on child labor, etc.

On page 270 there is a very important amendment which the Treasury Department particularly hopes will be passed, a provision for the expedition of claims and the final settlement of them. Beginning with line 16, page 270, the provision reads:

"If after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

The notion being that where the taxpayer agrees that the determination is just and the department thinks it is just they can come to an agreement and clean it up forever.

The CHAIRMAN. Dr. Adams, some of us do not think that smacks of very good constitutional flavor.

Dr. ADAMS. It is purely optional. There is no pressure on the taxpayer. If both of them get together I can not see why it should be objected to at all.

Senator SIMMONS. You say, "And no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

Dr. ADAMS. Well, if the taxpayer agrees to this there is no pressure put on the taxpayer.

The CHAIRMAN. How can you determine the rights of a beneficiary who may acquire a right in a court? I do not want to have this bill go forth to the world, so far as I am concerned as a member of the committee, with anything that looks too unconstitutional.

(At this point a discussion occurred off the record, at the conclusion of which the following took place:)

Senator CURTIS. Mr. Chairman, Dr. Adams has made a memorandum to rewrite that portion.

Dr. ADAMS. Section 1002 of the proposed bill provides:

"In case a regulation or Treasury decision relating to the internal-revenue laws made by the commissioner or the Secretary, or by the commissioner with the approval of the Secretary is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent juris-

diction, such subsequent regulation or Treasury decision may, in the discretion of the commissioner, with the approval of the Secretary, be applied without retroactive effect."

Senator SMOOT. That is a tremendous power, is it not, to place in his hands?

Dr. ADAMS. At the present time if we change a decision we feel that we have to go back and change every tax to the beginning of time. It is one of the most unjust situations I know of. We have held that a common tax, for instance, does not apply to a producer or dealer. He then does not collect it when he sells his goods. Later on the decision of the department is changed and it is held that the tax ought to apply. Then we go back perhaps three years after the time to collect the tax from the man. An attempt to make reversals of Treasury decisions retroactive is one of the most unjust things to the taxpayer, one of the most irritating things that I know of. I have tried for years to get the Treasury Department not to do it. I wanted Congress to give them authority not to make it retroactive. I do not think it is safe to tell them that they shall not make them retroactive because very frequently they ought to do so in the interests of the taxpayer, but both of these regulations have been devised to relieve the taxpayer and make things easier and better on the whole; not to give any additional power.

Senator SMOOT. The way this is written the commissioner has discretion as to whether he shall apply it in one case and not apply it in another.

Dr. ADAMS. You must remember that these decisions go both ways. If the Treasury Department wants to abuse this power they can do so, but I do not see how any less discretion will enable them to relieve the taxpayer.

The CHAIRMAN. I am not going to argue, Doctor, but you have referred to both of these provisions as being of great importance. I still think the first one we have talked about is very crudely drawn. As to this second one, why can not the purpose be reached by some statute of limitations?

Dr. ADAMS. As I now see it, you can not apply the statute of limitations against the meaning of an act of Congress.

The CHAIRMAN. We do it all through the revenue bill. I have forgotten just where.

Dr. ADAMS. The meaning of what you have done is what is of importance.

Senator CURTIS. This is the decision of the commissioner that may be reversed.

Senator SMOOT. And he may himself reverse it.

Dr. ADAMS. He does constantly.

Senator SIMMONS. Doctor, you construe this to mean that in the case of a reversal the commissioner would have discretion to make it retroactive or not?

Dr. ADAMS. Yes, sir.

Senator SMOOT. Why not give him power to make it retroactive so that in all cases it will apply alike? Take a case where there are to be two rules laid down, one retroactive and one not retroactive.

Dr. ADAMS. Take the situation that I spoke of. When you first imposed these excise taxes in section 900—I was trying to think of the worst case I knew of—it was a border-line case as to whether it was within the description of your articles or not. A taxpayer involved wrote in and said: "Am I subject to the tax?" The amount of money involved was $400,000.

In the case I am speaking of the taxpayer was advised that the tax did not apply. He sold goods and did not collect the tax from the customer. Later a decision was rendered and the department proceeded to collect the tax from that man. That is one case where I think we should not make it retroactive. There are other cases where we have collected taxes—not border-line cases—when the taxpayer has paid the tax, and it was subsequently plainly held to be the law, and it was the opinion of the department, that the principle should not be applied. In those cases we want the matter taken care of so that we can repay the tax. We want to be able to give it back in cases of that kind. That is the thought underlying this.

Senator SMOOT. It does seem to me that that power should not be given to any man to say, in one case, it shall be retroactive, and, in another case of a similar kind, it shall not be retroactive. I think it should be retroactive. I think that is correct. If a wrong decision has been made, that decision in every case ought to be retroactive and the Government should make good, but I do not believe the commissioner should make it right in one case and not in another.

The CHAIRMAN. It does not seem to me that it would be clear where the line of demarcation would be as between retroactive and nonretroactive cases. I think it is an unfortunately worded provision.

Dr. ADAMS. Page 277, line 19:

"No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a 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."

The CHAIRMAN. On that point, complaint has been made to me that in some of these big corporations particularly as many as two or three different forces of inspectors are waiting in the outer office to follow each other making similar examinations. Would it not be possible to consolidate the Government's examinations so that one examination of books of accounts would be sufficient by certifying to some other department?

Dr. ADAMS. That is what this really means. That is what we have in mind.

The CHAIRMAN. This, as I understand it, is to prevent more than one section or bureau of a department——

Dr. ADAMS. Oh, do you mean the different departments?

The CHAIRMAN. Well, it might be referred to the Department of Commerce, for example, when the Department of the Treasury is through. There may be some one man waiting outside week after week for the purpose of making another examination.

Senator SIMMONS. There are many examinations made for different purposes.

The CHAIRMAN. No; for the same purpose.

Senator CALDER. Did you refer to the Department of Commerce?

The CHAIRMAN. Yes.

Senator LA FOLLETTE. The Federal Trade Commission might be making an examination to investigate the question whether or not there were unfair trade practices.

The CHAIRMAN. I am bringing it up because I want to have an amendment submitted to it.

Senator SIMMONS. Take an instance such as you mentioned. The Treasury Department would hardly make the same kind of an examination for the purpose of determining whether the Government had received the proper tax as the Trade Commission would probably make for the purpose of determining whether they are complying with certain trade laws.

Senator SMOOT. This does not affect the Federal Trade Commission at all.

Senator WALSH. No one who makes an honest return has to care how many examinations the Government makes.

Senator SMOOT. I know of a case where four examinations were made, and not one of the four ever agreed upon what the examination showed.

Senator WALSH. I have had clients who complained, but everyone had a crooked account.

Dr. ADAMS. This is not a drastic provision.

The CHAIRMAN. No, Dr. Adams; it is not. I was really thinking of having that elaborated. Proceed.

Dr. ADAMS. Line 13, page 278. This gives wide discretion to the Treasury Department in the manner of collecting taxes:

"SEC. 1307. That whether or not the method of collecting any tax imposed by Titles V, VI, VII, VIII, and IX, or X of this act is specifically provided therein, any such tax may, under regulations prescribed by the commissioner with the approval of the Secretary, be collected by stamp, coupon, or serial numbered ticket. All administrative and penalty provisions of Title XI, in so far as applicable, shall apply to the collection of any tax which the commissioner determines or prescribes shall be collected in such manner."

I recall no change, until we get over to page 304.

Senator CURTIS. Dr. Adams, why do you ask us to authorize the creation of a simplification board?

Dr. ADAMS. We do not ask it, Senator; the Treasury Department is not urging it. The Republican platform calls for a simplification board. That is done in obedience to that request. The department does not ask for this. It did not emanate from the department, at least.

Senator MCLEAN. Does this add to the expense?

Dr. ADAMS. Not very much.

Senator CURTIS. It will add to the expense unless you select the personnel from members in the department.

Dr. ADAMS. None is paid.

"(a) There is hereby established in the Department of the Treasury a board to be known as the 'Tax Simplification Board' (hereinafter in this section called the 'board'), to be composed as follows:

"(1) Three members who shall represent the public, to be appointed by the President; and

"(2) Three members who shall represent the Bureau of Internal Revenue and shall be officers of the United States serving in such bureau, to be appointed by the Secretary of the Treasury.

"(e) Any vacancy in the board shall be filled in the same manner as the original appointment. The members representing the public shall serve without compensation except reimbursement for traveling, subsistence, and other necessary expenses incurred in the performance of the duties vested in them by this section. The members representing the Bureau of Internal Revenue shall serve without compensation in addition to that received for their service in such bureau.

"(c) The Secretary of the Treasury shall furnish the board with such clerical assistants, quarters, and stationery, furniture, office equipment, and other supplies as may be necessary for the performance of the duties vested in them by this section.

"(d) It shall be the duty of the board to investigate the procedure of and the forms used by the bureau in the administration of the internal revenue laws and to make recommendations in respect to the simplification thereof. The board shall make a report to the Congress on or before the first Monday of December in each year.

"(e) The expenditures of the board shall be paid upon vouchers approved by the board and signed by the chairman thereof. For the expenditures of the board for the fiscal year ending June 30, 1922, there is authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, the sum of $10,000.

"(f) The board shall cease to exist on December 31, 1924."

Senator SMOOT. How are you going to make a report on or before the first Monday of December of each year when Congress meets on the first Monday? You say here it shall be made before.

Dr. ADAMS. On or before that should be.

Senator MCCUMBER. A word on the merits of that. Suppose that you and Mr. McCoy and others represent the Treasury Department, and here are 16 members who represent the public. We have everything that you have in that commission. Why go to work to simplify it now? Why shift it over to some other commission to do it?

Dr. ADAMS. That is not a Treasury recommendation. It was not recommended by the Treasury Department. The Republican platform calls for a thing of this kind.

Senator LA FOLLETTE. You do not think that is binding now, do you?

Dr. ADAMS. This carries out the idea of the platform. The thought underlying it was to have the public represented in the forms, and so on, and to bring the outside public in and get the current of ideas that would come. There are three members representing the department who could make a minority report if they thought it was not simplified, and so on.

Senator MCCUMBER. The experts have simplified it and submitted it to these people who represent the public. If you can simplify it so that those who are to form this board can understand it, I believe that you can simplify it to such an extent that the members of this committee can understand it, too. I think it would be a pretty good thing to do that now and not wait for a commission to be formed. I think you will agree with that.

Dr. ADAMS. I agree with you on that, Senator McCumber. The expert, as you know, sometimes fails to see the forest for the trees. He begins to love his details. I am a sort of an expert, but I know my weaknesses.

"SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor in the hands of the executors or administrators is insufficient to pay all debts due from the deceased, the debts due the United States shall first be satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed. Whenever a petition in bankruptcy shall have been filed the clerk of the district court in which the same is pending shall within three days after the entry of such petition of record give notice of such fact to the collector of internal revenue for the collection district in which the alleged bankrupt resides."

That last part is the principal change in the law.

Senator CURTIS. Is the first part already in the law?

Dr. ADAMS. As I recall, it is.

Senator CURTIS. Does that put your tax ahead of a doctor's bill, for instance?

Dr. ADAMS. Yes; it does now.

Senator CURTIS. Under our State laws such bills are put first.

Dr. ADAMS. In many States that is true. Section 1008 of the proposed bill, H. R. 8245, provides:

"(a) Title II of the revenue act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917."

Before I go any further, may I say a word of explanation in regard to this? You will remember that under the revenue act of 1917, without an explicit statement in the law, the consolidated return was accepted, and probably 75 per cent of the corporation taxes collected that year were collected on the basis of consolidated returns. I have some reason to believe that perhaps that was without warrant of law; it may be invalid. It is here proposed to validate that procedure in order that those taxes may not be endangered; that is, the collection made at that time.

"(b) For the purposes of this section a corporation or partnership is affiliated with one or more corporations or partnerships (1) when such corporation or partnership owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or (2) when substantially all of the stock of two or more corporations or the business of two or more partnerships is owned by the same interests: *Provided*, That such corporations or partnerships are engaged in the same or a closely related business, or one corporation or partnership buys from or sells to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranges its financial relationships with another corporation or partnership as to assign to it a disproportionate share of the net income or invested capital.

"(c) The provisions of this section are declaratory of the provisions of Title II of the revenue act of 1917."

Senator SMOOT. You are putting the regulations into law, that is what this is?

Dr. ADAMS. Yes.

Line 7. This is a similar provision validating the treatment of personal service corporations. The doubt there is whether it is constitutional. The method is specifically stated in the statute. We taxed them in 1918 as partnerships and exempted them from the excess-profits tax. The decision of the Supreme Court of the United States in the stock dividend cases makes it doubtful whether that is constitutional. In order to make sure, we are putting this in.

"(a) If subdivision (e) of section 218 of the revenue act of 1918 is by final adjudication declared invalid, there shall, in addition to all other taxes, be levied, collected, and paid on the net income received during the calendar years 1918, 1919, 1920, and 1921, by every personal service corporation included within the provisions of such subdivision, a tax equal to the taxes imposed by sections 230 and 301 of the revenue act of 1918, as in force prior to the passage of this act. In such event every such personal service corporation shall, on or before the 15th day of the third month following the date of such final adjudication, make, in the manner provided by the revenue act of 1918, a return for the calendar years 1918, 1919, 1920, and 1921. Such tax shall be assessed, collected, and paid upon the same basis, in the same manner, and subject to the same provisions of law including penalties, as the taxes imposed by sections 230 and 301 of the revenue act of 1918, as in force prior to the passage of this act, but no interest shall be due or payable thereon for any period to the date upon which the return is herein required to be made and the first installment paid. The amount of any tax paid by any shareholder or member of a personal service corporation pursuant to the provisions of subdivisions (e) of section 218 of the revenue act of 1918"—that is the subdivision imposing tax upon the stockholders of a personal service corporation and upon the members of a partnership—"shall be credited against the tax due from such corporation under this section upon the joint written application of such corporation and such shareholder or member or his representatives, heirs or assigns, if such application is filed with the commissioner within 90 days from the date of such final adjudication.

"(b) Notwithstanding any other provision of law, no claim for a credit or refund of taxes paid under subdivision (e) of section 218 of the revenue act of 1918 may be filed after the expiration of 90 days from the date of such final adjudication of invalidity."

Senator SIMMONS. Take the claim you are speaking of—personal service corporations, 1918, 1919, and 1920. They are not supposed to have paid excess profits taxes. They have not kept books for that purpose, perhaps.

Dr. ADAMS. The corporation shows its net income on its books. It has to have that in order to find the shares of the shareholders. They must do it; it is law. The partnership determines its income and the members of the partnership pay on their distributive shares.

Senator SIMMONS. The idea prevails that the excess profits tax was passed on, as far as possible, to the consumer. Now, these people during these four years, have not supposed that they had to pay any excess profits taxes, and have not passed them on. Would it not be inequitable, therefore, to go back and make them pay that tax now?

Dr. ADAMS. No. This provides that if this personal service method is declared unconstitutional, then, in the first instance, the tax shall be paid by the corporation, but the stockholders may agree to let the old taxes stand in lieu of the new. Not only may they do that, but if they fail to do it within 90 days, they can file no claim for a credit or refund of taxes. You will see that more clearly as I go on.

"(b) Notwithstanding any other provision of law, no claim for a credit or refund of taxes paid under subdivision (e) of section 218 of the revenue act of 1918 may be filed after the expiration of 90 days from the date of such final adjudication of invalidity: *Provided, however*, That a personal service corporation of which no shareholder or member has filed such claim within the period herein limited shall not be subject to the tax imposed by this section."

In other words, if within 90 days some of the shareholders do not claim the right to get a refund, then the old tax which was imposed is taken in lieu of the new tax.

The next provision, gentlemen, is a provision to extend slightly the borrowing authority of the Treasury Department in view of the tax reductions made in the House.

Senator SMOOT. To the extent of $500,000,000?

Dr. ADAMS. Yes.

"Subdivision (a) of section 18 of the second Liberty bond act, as amended, is amended by striking out the words and figures 'for the purposes of this act, and to meet public expenditures authorized by law, not exceeding in the aggregate $7,000,000,'" and inserting in lieu thereof the words and figures, "For the purposes of this act, to provide for the purchase or redemption of any notes issued hereunder, and to meet public expenditures authorized by law, not exceeding in the aggregate $7,500,000,000 at any one time outstanding."

Senator SIMMONS. What is that $500,000,000 for?

Dr. ADAMS. What is that for?

Senator SIMMONS. Yes.

Dr. ADAMS. I should prefer to let the Secretary of the Treasury discuss that when he comes. I understand that he will be here to-morrow. That raises questions that I should prefer to have him discuss.

Senator REED. Is that raised by selling certificates?

Dr. ADAMS. There is plenty of authority to sell certificates now, Senator.

Senator SIMMONS. Suppose we do not authorize the Treasury to borrow money, do we then have to raise it by taxes?

Dr. ADAMS. This is really not involved.

Senator SMOOT. This has reference to the second Liberty bond act.

Senator SIMMONS. It does not make any difference. What I want to know is whether that $500,000,000 is going to be raised by taxation if it is not borrowed in this way.

Dr. ADAMS. No, sir; we have plenty of leeway under present law. I would rather have the Secretary discuss this question.

The CHAIRMAN. I do not think it is a minor thing.

Mr. BEAMAN. I notice the language is "At any one time outstanding." Isn't the effect to increase not only the $500,000,000 but when these Victory notes fall due wouldn't this give authority to issue $7,500,000,000 more to refund them?

Senator WATSON. Dr. Adams has asked that we discuss this with the Secretary of the Treasury, and I think that should be done.

The CHAIRMAN. Does that close your statement with reference to the bill, Dr. Adams?

Dr. ADAMS. You have now a provision simplifying, so far as it is possible, the present variable and highly complex exemptions of the Liberty bond acts. This simplification provision is designed for the purpose of getting rid of that complexity.

"The various acts authorizing the issues of Liberty bonds are amended and supplemented as follows:

"(a) On and after January 1, 1921, 4 per cent and 4½ per cent Liberty bonds shall be exempt from graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States upon the income or profits of individuals, partnerships, corporations, or associations, in respect to the interest on aggregate principal amounts thereof as follows:

"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 of the President, on $125,000 aggregate principal amount, and for three years more on $50,000 aggregate principal amount.

"(b) The exemptions provided in subdivision (a) shall be in addition to the exemptions provided in section 7 of the second Liberty bond act, and in addition to the exemption provided in subdivision (3) of section 1 of the supplement to the second Liberty bond act in respect to bonds issued upon conversion of 3½ per cent bonds,

but shall be in lieu of the exemptions provided and free from the conditions and limitations imposed in subdivisions (1) and (2) of section 1 of the supplement to second Liberty bond act and in section 2 of the Victory Liberty loan act."

Section 1011 of the proposed bill (H. R. 8245) provides:

"The portions of the Revenue Act of 1918 repealed or amended by this act shall remain in force for the assessment and collection of all taxes which have accrued or may accure under the revenue act of 1918 as in force prior to the passage of this act, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any such taxes."

Section 1012 of the proposed bill (H. R. 8245) provides:

"Except as otherwise provided, this act shall take effect upon its passage."

Senator CURTIS. What would the aggregate amount of exemptions be under this?

Dr. ADAMS. The aggregate limit of exemptions was approximately $160,000. The principal change is that we get out of this limiting provision of having to subscribe to the original stock issue.

Senator REED. Let us see about this. Under the old law a man had to subscribe to the original issue, whereas now he can go into the market and buy bonds and get exemption. Wouldn't that make quite a big difference?

Dr. ADAMS. Most of those men have their exemptions filled up anyhow.

Senator REED. There will be others coming on.

Dr. ADAMS. As far as I am concerned, we do not care whether you do it or not. It is a question of simplification for the benefit of the taxpayer.

Senator REED. I assume that the Treasury Department is going to act in good faith.

Senator SMOOT. It takes up nearly a page of return to answer these questions.

Senator REED. I can see a great difference that might result from it, but I am not going to suggest it.

Dr. ADAMS. We can not check it up. We can not tell whether a man got bonds and held them and has taken one and one-half times the orginal subscription, and so on. As a matter of fact, this is the most complex schedule in the tax returns. If you will go over it once more, you will see what it is.

Senator REED. I want to ask a question along another line, when you are through with the bill.

Dr. ADAMS. Very well.

Senator REED. The question I want to ask is this. You will remember there was a decision rendered by the courts. I have forgotten for the instant the title of the case. However, they held that the value of the property which was assessed was to be determined by the amount of the original investment rather than upon the later value. I am speaking now of properties, not values. Do you remember the title of that case, by the way?

Dr. ADAMS. I think it was the La Belle Iron Co. case.

Senator REED. Yes; I think it was. Is that changed in this?

Dr. ADAMS. Not at all. The excess profits tax is repealed as of January 1, 1922, but no internal change is made in the excess profits tax.

Senator REED. That decision would have no effect?

Dr. ADAMS. The decision would hold forever in excess profits tax cases.

Senator REED. I mean it will have no further effect under this bill?

Dr. ADAMS. Not at all.

Senator REED. If we accept the action of the House on the excess profits tax, it would have no effect, but if we do not, then this decision would still stand, as a matter of law?

Dr. ADAMS. Yes.

Senator WATSON. But it would still stand, even though we made the repeal retroactive from January 1, 1921?

Dr. ADAMS. Yes; for past cases.

Senator SMOOT. We do not want to begin now with the consideration of rates until after we hear the Secretary of the Treasury. I think we might as well adjourn until to-morrow morning.

The CHAIRMAN. If it is the pleasure of the committee, we shall adjourn at this time until 10.30 o'clock to-morrow morning, when the Secretary of the Treasury will be here.

I want to thank you, Dr. Adams, for the prolonged and illuminating statement you have made with regard to this whole subject.

Senator WATSON. Of course, Dr. Adams will continue.

The CHAIRMAN. I know that, but I would like to recognize what he has already done.

(Thereupon, at 1 o'clock p. m., the committee adjourned until to-morrow, Thursday, September 8, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

THURSDAY, SEPTEMBER 8, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Reed, and Walsh.

Present also: Hon. Andrew W. Mellon, Secretary of the Treasury; Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. The committee will come to order.

The Secretary of the Treasury is present, according to arrangement, to express his views to the committee.

The committee, Mr. Secretary, has completed the reading of the bill with accompanying explanations by Dr. Adams and is now prepared to take the measure up for amendment and consideration of policies, and will be glad to hear from you.

STATEMENT OF HON. A. W. MELLON, SECRETARY OF THE TREASURY.

Secretary MELLON. I have not prepared any written statement. I supposed that it would be just a question of taking up the items that you may desire to ask me about in reference to the House bill as it is before you and in regard to the revenue that is required.

The CHAIRMAN. I think the committee would like to hear, Mr. Secretary, as to the revenue-producing powers of this bill, and whether you need more money or not, and what is the latest thought on those points.

Secretary MELLON. The table which we have printed and which is now before you shows that, under the House bill, the estimated receipts for the fiscal year 1922 will amount to $3,389,455,000; for the calendar year, to $2,960,490,000.

That is the estimate. Of course, the question of expenditures is one which we can not accurately gauge, but as it stands it covers the estimates of expenditures, though it is scant. I mean by that it is not over the amount that we think we will be called upon for.

The CHAIRMAN. Have you any amendment, Mr. Secretary, to submit to the committee for additional sources of revenue?

Secretary MELLON. As it stands, there would probably not be any additional source of revenue required, unless you consider the question of eliminating the excess-profits tax from the beginning of 1921, and the reduction of surtax rates. If those reductions are made, or if the excess-profits tax is eliminated at that time, then there will have to be other sources to take the place of the losses.

It would work out by adding to the corporation income tax, which in the House bill is 12½ per cent, 2½ per cent, thus making that 15 per cent, and making some other changes which would take the place of the income tax for that time. It is just a question of what policy you desire to pursue.

The CHAIRMAN. You mean the excess-profits tax?

Secretary MELLON. Yes.

The recommendation to the House from the Treasury was to take off the excess-profits tax from the beginning of 1921 and to reduce the surtaxes beginning with 1921, but there were other changes made by the House committee which made it necessary to have the additional revenue. I mean by that the increase in exemptions and the other changes that were made. They made that necessary.

Senator SMOOT. Did I understand you to say, Mr. Secretary, that the House bill will produce sufficient revenue to pay the expenditures of the Government?

Secretary MELLON. Provided the departments' requirements are kept within the bounds to which they were cut; that is, that they are kept within the amounts that are authorized and the agreement as to cuts is kept; that is, according to the agreement at the administration conference.

Senator SMOOT. Let me see if I understand you. The appropriations that have been made to date amount to $3,960,338,367.

Senator REED. Senator Smoot, please give me those figures.

Senator SMOOT. $3,960,338,367, including the last appropriation for the Shipping Board.

Secretary MELLON. That is for the fiscal year.

Senator SMOOT. Yes. Included in this appropriation is an item of receipts from the Post Office Department.

Secretary MELLON. Yes.

Senator SMOOT. Deducting the receipts from the Post Office Department, estimated at $500,000,000, leaves the amount of appropriation made $3,460,338,367. Your estimate, as given in this committee print submitted to us this morning, for the fiscal year 1922 is $3,389,455,000. That would fall short of paying the appropriations, after deducting the Post Office receipts from them, and yet that is not all the obligations that we have to meet. We will have to meet unexpended balances that are bound to be used in the War Department and in the Navy Department, and in addition to that I have not any doubt but that the claims against the Shipping Board, together with what we have to meet will be $100,000,000. I have no doubt but that the unexpended balances of the War Department and the Navy Department will amount to $200,000,000. That is $300,000,000.

The CHAIRMAN. Senator Smoot, you are making your estimates as a member of the Committee on Appropriations, are you not?

Senator SMOOT. I am not making an estimate at all. I am giving the figures of what we actually appropriated. I am making an estimate as to the amount of the unexpended balances that the Treasury of the United States has got to take care of. In other words, we have a lot of appropriations that we made, not for the fiscal year, but until expended, and that is what I have reference to.

The CHAIRMAN. I see. I misunderstood you for a moment.

Senator SMOOT. I can not see, Mr. Secretary, how we can pay the obligations of the Government of the United States unless out of these appropriations that have been made there will be at least $400,000,000 saved.

Secretary MELLON. What would be your estimate of the result or of the amount required afterwards?

Senator SMOOT. $3,760,000,000.

Senator WALSH. That is, taking out the Post Office receipts?

Senator SMOOT. Yes; taking out the Post Office receipts.

Senator MCLEAN. That is what is needed.

Senator REED. Did you say $3,760,000,000?

Senator SMOOT. Yes; to meet the unappropriated balances. There are the claims against the Shipping Board, which must be considered and which will probably amount to at least $100,000,000. The estimated amount by the Treasury Department for the fiscal year 1922 is $3,389,455,000.

Senator WATSON. Does that include the repeal of the excess-profits tax? Is that retroactive?

Senator SMOOT. No. That is not retroactive at all. That is taking into consideration $669,000,000 for profits tax.

The only way to make up that difference that I know of is to save money out of appropriations that are already made. This is not taking into consideration a single deficiency appropriation bill. We have had two of them already. I think more than likely we shall have three more. I can not tell you how much that amounts to, but for the life of me I do not see how you are going to pay the running expenses of the Government under this bill even with the collection of the excess-profits tax.

Secretary MELLON. I think all the appropriations that have been made have been taken into account. Then we have in addition to the revenue you speak of, the customs and miscellaneous revenue from salvage and other sources.

Senator SMOOT. There is no question in your mind, is there, that we have appropriated $3,960,338,367? If there is, I can give you every item, if you want it. There is not one single item that I can not give you.

Secretary MELLON. But we have taken into account the reductions that have been made. The total expenditures, including the sinking fund and miscellaneous debt retirements for the fiscal year 1922, are estimated at four billion thirty-four million and odd.

Senator CURTIS. That is more than you have there.

Senator SMOOT. I know the amount to the very cent. I will give it to you down to the last cent, if you want it.

Secretary MELLON. The requirements of expenditures for the fiscal year are estimated at $4,034,012,000. We have revenues from nontax sources of something over $800,000,000; that is, including customs and miscellaneous items.

Senator SIMMONS. What do you estimate the amount of the customs to be?

Secretary MELLON. We have estimated customs at about $350,000,000 for the fiscal year.

Senator SIMMONS. Then you would have $500,000,000 for miscellaneous?

Secretary MELLON. Well, the miscellaneous is $487,000,000. Deducting that——

Senator SMOOT (interposing). What do you count in these miscellaneous items?

Dr. ADAMS. Salvage, the sale of public lands, Panama Canal tolls, the repayment of debts—all those items that are detailed and specified in the copies of the two letters which have been distributed on your desks, dated August 4 and August 10. The letter of August 10 corrected some of the estimates of expenditures, and I think that this miscellaneous nontax revenue that the Secretary speaks of—the letter of August 10—was estimated at $857,000,000. Since that time Mr. McCoy has called attention to the fact that the customs have been overstated, so that the total ought to be approximately $800,000,000.

Secretary MELLON. Deducting that from $4,034,000,000, leaves $3,234,000,000, in round figures, to be provided by taxation.

Senator SMOOT. You do not deny that the appropriation amounted to $3,900,338,432.18? Those are the regular appropriations.

Secretary MELLON. I do not know. There were appropriations and then cuts.

Senator SMOOT. No, these are the absolute amounts that were finally appropriated. So that the record may show it, Mr. Chairman, I shall put these appropriations in—every item that has been appropriated to date for the fiscal year 1922.

Senator REED. I think it not only a good thing, but I think it ought to be printed separately in a table for the use of the committee and use on the floor.

Senator SMOOT. Well, I shall get them for you, because I have enough for the committee in my office.

In this connection, Mr. Secretary, these $3,900,000,000 that have been appropriated do not provide in any way for the unexpended balances; that is, the appropriations have been made, not for the fiscal year, but made until they are expended. What is your estimate of the amount it will cost the Government of the United States from that source?

Dr. ADAMS. May I answer that?

Senator SMOOT. Yes. I shall be glad to have anybody answer it.

Dr. ADAMS. It is necessary to give a little history in order that this matter may be understood correctly. The Treasury Department collected with great care, and corrected up to August 3 and back, the estimates of expenditures from the various departments. Those estimates of expenditures cover, not only the current appropriations, but available balances. For instance, the War Department, whose current appropriation is only $387,000,000, turned in an estimate of $450,000,000. That is a good illustration. They were estimating, where they had an available balance, what they would spend in addition.

Now, the total of this appropriation for the fiscal year—and this is important—was $4,554,000,000.

Senator REED. Do you mean appropriation or estimate? You used the word "appropriation."

Dr. ADAMS. Oh, that is wrong. It is the estimated expenditure. There followed then the conference with the President in which the various executive heads promised not to spend all that money. There was an arrangement made by which they cut off $520,000,000—$520,000,000 deducted from the $4,554,000,000 leaves the figure of $4,034,000,000, which is the estimate of expenditures likely to be made and which the Secretary has been counting on. It is somewhat different from an appropriation because it is an estimate of what they are actually going to spend.

Senator SIMMONS. Did I understand you to say that the appropriation would amount to $4,554,000,000?

Dr. ADAMS. Not the appropriation—the expenditures.

Senator SIMMONS. The expenditures, I meant to say, would amount to that, but that certain departments had promised to spend $500,000,000 less than that?

Dr. ADAMS. That is exactly it. That is recorded in the letter of August 4.

Senator CURTIS. That is, they would not use the amount appropriated for that department. One department said it would cut so much and another said it would cut so much.

Senator REED. In other words, to put it in correct form, they made estimates of what they wanted that had not been given and then the President called them in and they agreed to reduce their estimates.

Senator CURTIS. You are mistaken in that, Senator Reed. The estimates were made by the old Secretaries.

Senator REED. But for these present appropriations they came in with estimates.

Senator CURTIS. No; the estimates had not come in yet.

Senator REED. The estimates were sent in by the former administration?

Senator CURTIS. Yes.

Senator REED. These gentlemen had a meeting with the President and they agreed they would get along with less money and it has not been appropriated?

Secretary MELLON. That is exactly right.

Senator SMOOT. It has been appropriated.

Secretary MELLON. Oh, yes; it has been appropriated.

Senator SMOOT. Let us get at the history of the thing.

Senator MCCUMBER. Let me see first if I understand the Secretary. The estimate, I understood you to say, was $4,500,000,000?

Secretary MELLON. Originally.

Senator SMOOT. It was $5,440,000,000.

Secretary MELLON. $4,554,000,000.

Dr. ADAMS. There is a difference there. There are all kinds of ideas here. There is a total of appropriations and unexpended balances. The question now is, how much are you going to spend? For instance, the Department of Agriculture had a certain appropriation for good roads. A reduction in that figure did not solve the Treasury Department's problem for controlling cash. The thing now is, how much money are you going to spend? That is the figure with which to start. It is all authorized.

Senator SMOOT. If that is what you are going to do, then I have nothing more to say.

Senator MCCUMBER. I understand that the previous administration made these estimates that it would require $4,500,000,000 to operate the Government during the next fiscal year.

Dr. ADAMS. No, sir. The estimates checked up to the 3d day of August of this year show an expectation of expenditure for the present fiscal year of $4,550,000,000.

Senator SMOOT. Then you cut that down?

Secretary MELLON. Then we took it up separately with the different departments. The department heads agreed to cut $350,000,000 at this conference, which you deduct from that $4,550,000,000. Now, in addition to that deduction or cut, out of the proposed expenditures of the department there was an item of public debt expenditure amounting to $170,000,000; there was $100,000,000 of war savings maturities—war savings certificates—and $70,000,000 of expenditures under the Pittman Act that were required to be paid. Those requirements were eliminated. In other words, it was left so that these payments of the public debt would not be made and the two together made about $520,000,000, which, deducted from $4,554,000,000, left this item of $4,034,000,000, and that item of $4,034,000,000 is what is estimated for the requirements of the fiscal year 1922.

Senator WALSH. I want to ask Senator Smoot if in the past, in determining how the Government should be financed, whether he considered appropriations made by Congress or by private agreements made by department heads?

Senator SMOOT. Of course, we have always considered the appropriations made, and they have never kept within the agreement.

Senator WALSH. Isn't it rather dangerous to rely on these agreements?

Senator SMOOT. Considering that they have this private understanding that they are going to save $500,000,000, I have not a word to say, because I think that with the House bill, provided we collect this $669,000,000 for profits taxes, the amount will be ample.

Senator CURTIS. And provided they save $500,000,000.

Senator SMOOT. That is what I say.

Senator WALSH. Is that a wise policy to pursue—for the administration to rely upon a previous one?

Senator SMOOT. It is all right if you can do it.

Senator REED. The way to do it, if that is to be done, is, in this bill, to reduce those appropriations to the amount they have agreed upon. If it will not bother the committee, I should like to get at this thing in categorical order.

Senator SMOOT. Senator Curtis made some statement about the estimates of the past administration for this year, as I understand it. I have that here.

Senator REED. They were estimates made by heads of departments?

Senator SMOOT. Coming through the Secretary of the Treasury, according to law' but made by each one of the departments, and passing through the hands of the Secretary.

Senator SIMMONS. When were they made?

Senator SMOOT. The law requires that they must be made by September 16.

Senator REED. How much were they?

Senator SMOOT. $5,440,207,438.18.

Senator REED. All right; just a moment. I have in mind what I want to get at. That was an estimate made in September or October by the Wilson administration, was it not?

Senator SMOOT. Yes.

Senator REED. And was reported to the Congress as the wants or necessities of the various departments for the present fiscal year which begins——

Senator SMOOT (interposing). July 1, 1921, and ends July 1, 1922.

Senator REED. Yes. Now, those appropriations came over to Congress——

Senator SMOOT (interposing). Those estimates?

Senator REED. Yes; those estimates came to Congress and Congress proceeded, as it always does, to try to ascertain how much the departments needed and cut down their estimates by appropriating less sums.

Senator SMOOT. Not as they always do, but as they certainly did in this year.

Senator REED. I have never known a time when they have not done that. Now, Congress appropriated——

Senator SMOOT (interposing). Congress appropriated $3,960,338,432.18. That is the appropriation made including the last appropriation in the urgent deficiency bill to take care of the Shipping Board estimate of $50,556,222.72.

Senator REED. Those are the appropriations to date.

Senator SMOOT. That is the total appropriation to date.

Senator REED. And they are still asking for additional appropriations?

Senator SMOOT. There are no estimates now before the Appropriations Committee.

Senator REED. But you estimate there will be further demand?

Senator SMOOT. There is no doubt about it.

Senator REED. How much, in your judgment?

Senator SMOOT. Of course, my judgment now, with what I have heard to-day, if these plans are carried out, will be greatly modified, because if this is carried out——

Senator REED (interposing). Let us get the demands, the further demands, and then we will talk about what, in your judgment, must necessarily come in. That is what I want to get at.

Senator SMOOT. Senator Reed, it will not be very much more if they carry out the policy that they have outlined. There will be small items that can not be foreseen.

Senator REED. If they do not carry it out, how much did you say a little while ago you would estimate it would amount to?

Senator SMOOT. $300,000,000; that is, they would have to raise money from some source to the extent of $300,000,000, if the agreement were not carried out.

Senator REED. When the new officers came in on March 4, they did not change these former estimates until the President called them in, and then there was an agreement made to cut off $350,000,000.

Senator CURTIS. They could not change the estimate.

Senator SMOOT. Congress did that itself.

Senator CURTIS. The extra session of Congress did that.

Senator REED. We did not appropriate $5,440,000,000; we appropriated $3,960,000,000.

Senator SMOOT. Yes.

Senator REED. Now, there has been nothing sent to Congress by the administration telling us to rescind any part of those appropriations, but there was a meeting between the President and his Cabinet members in which they agreed that they would try to cut off $350,000,000.

Senator SMOOT. I do not know anything about that, but I do know this, that hearings were held by the Appropriations Committee of the House and also by the Appropriations Committee of the Senate on these estimated amounts, and those two committees cut from the estimated amount the difference between $3,960,000,000 and $5,440,000,000.

Senator REED. Exactly. There is just one thing further.

Senator SIMMONS. May I ask a question right here? When you made these appropriations in pursuance of these estimates and reduced the estimates to the extent that your figures show, didn't you have the department heads before you and didn't you think you were cutting it to the bone?

Senator SMOOT. You mean when we cut it to $3,960,000,000?

Senator SIMMONS. Yes.
Senator SMOOT. Yes; we did.
Senator REED. You had the department heads before you at that time?
Senator SMOOT. I would not say all of them, because we did not.
Senator REED. After the time that the $5,440,000,000 estimates were made, didn't the Congress cut down the size of the Army?
Senator SMOOT. Yes; they did.
Senator REED. From 227,000 men to 150,000 men?
Senator SMOOT. From 221,000 men to 175,000 men.
Senator REED. And then afterwards they cut from 175,000 to 150,000?
Senator SMOOT. Yes; that is right.
Senator REED. And that is a part of the saving.
Senator SMOOT. Yes.
Senator REED. The naval program upon which the estimate of $5,440,000,000 was made was reduced also, was it not?
Senator SMOOT. I will tell you just the amount in a minute.
Senator CURTIS. The last estimate was $487,322,000.
Senator SMOOT. We appropriated $410,673,289.73.
Senator SIMMONS. That was the estimate at what time?
Senator SMOOT. That is the first estimate that came in.
Senator REED. A part of this money that you are going to use this year and which will not be carried in these appropriations is money that will be received from what you call outside sources. One of those sources is the old war materials that we are selling, out of which you expect to get $200,000,000.
Senator SMOOT. That was taken into consideration. That was taken into consideration when we made the appropriation of $369,000,000.
Senator REED. That would have been out of the $5,440,000,000 which these heads of departments had demanded or requested. There was another source of income which the Secretary spoke of. How much was that?
Secretary MELLON. The customs.
Senator REED. You estimated that would be how much?
Secretary MELLON. $350,000,000.
Senator REED. $350,000,000?
Secretary MELLON. $300,000,000.
Senator REED. That is all that we get out of this great hurrah?
Secretary MELLON. We have the new law.
Senator REED. You mean the increased amount?
Secretary MELLON. The amount for this fiscal year. We will get more than that when this bill passes.
Senator WALSH. Then there is other miscellaneous revenue.
Senator REED. Yes. What is that made up of?
Secretary MELLON. $287,000,000 is miscellaneous revenue. There are a number of items. For instance, I might give you these——
Senator REED (interposing). Licenses, etc., would cover it, would it not?
Secretary MELLON. From the Federal reserve franchise tax, $60,000,000; interest on foreign obligations, $25,000,000; repayment of foreign obligations, $30,000,000; Panama Canal tolls, $14,530,000. Then, there is the sale of surplus war supplies. Assuming we take that into account, there are then miscellaneous items amounting to $150,000,000.
Senator SMOOT. That is, the sale of public lands, the sale of royalties on oils, receipts from forest reserves, and from all different sources of miscellaneous receipts.
Senator REED. Of course, as to salvage, I suppose we will get that only once; that is, it does not come in every year.
Senator SMOOT. It will for a number of years, Senator. We have the item of salvage which we estimate for the fiscal year at $250,000,000, but the next fiscal year ought to be as much as that.
Senator REED. You estimate $25,000,000 on foreign loans. That is all you expect to get this year, is it?
Secretary MELLON. That is uncertain. There may be more, but you can not count on it.
Senator REED. You do not feel safe in counting on more?
Secretary MELLON. I believe that nearly $25,000,000 has been paid.
Senator REED. Do you expect to get moore?
Secretary MELLON. We may or we may not; but we are counting only on what we can count on
Senator WALSH. That has been paid since July 1—that $25,000,000; is that correct?
Secretary MELLON. I do not know just exactly, but that is a safe estimate for the year.

Senator REED. There is another item I would like to inquire about, for I think it is of great importance that the committee should consider it. That is the item of taxes which may be collected under the decision that I spoke of on yesterday—the La Belle Iron Works case. Have you ever made an estimate, Dr. Adams, or Mr. Secretary, of how much taxes you are going to get by virtue of that decision?

Secretary MELLON. We have made an estimate of what we are likely to get, and think we may be able to get out of back taxes, which would include what you are speaking of. For this fiscal year of 1922 we estimate $235,000,000 out of these back taxes.

Senator REED. Is a large part of that made up of taxes that will be paid under this decision?

Secretary MELLON. I do not think you can determine just what proportion that can be collected in that direction will be collected. The part that we estimate is about $235,000,000.

Senator REED. I was trying to get at the magnitude of it.

Senator SMOOT. Isn't that for the calendar year 1921? I mean your estimate of $235,000,000?

Secretary MELLON. No; the fiscal year.

Senator SMOOT. We have collected more than $235,000,000. We have collected over $300,000,000.

Dr. ADAMS. Senator, we have, but part is stopped. We assess about $30,000,000 a month, but part of it is stopped by claims in abatement.

Senator SMOOT. I am aware of that; but even with that I have no doubt that the back taxes for this fiscal year will be over that.

Dr. ADAMS. Mr. McCoy and myself have studied that with particular care. The figures that we have here were arrived at after days of thought. That is net cash.

Secretary MELLON. You understand there are abatements and payments out of the Treasury?

Senator SMOOT. I figured that on the offside. If you consider that, I doubt if you can arrive at that figure. My estimate, then, would be about $170,000,000.

Dr. ADAMS. The rebates are provided for in a separate expenditure class. But we want to be conservative. We put it at $235,000,000 for the calendar year 1922 and $340,000,000 for the calendar year 1923.

Senator REED. I do not know of a better time to get the opinion of the Secretary than now with reference to the decision of which I spoke a moment ago. That decision was regarded generally as almost revolutionary. If I understand it, the theory of the bar of the country pretty generally was that when they came to estimate the profits made for the income taxes, they would take as the basis of it the value of the property, but when they finally got that case up to the Supreme Court, the Supreme Court sustained the Treasury's position that it was the investment in the property. Accordingly that created this sort of condition.

A had bought a piece of land on which he had erected a factory 40 years ago, and he got the land very cheap. They took that as the basis of his profits. They took as the basis of his income the price that he paid plus his taxes and some things of that kind.

B bought property 40 years later and paid the full price. The two institutions were then in competition with each other. The man who bought his property away back years ago and held it was required to pay an enormous tax, while the man who bought later paid a very much smaller tax.

Mr. Hughes, Mr. Wickersham, Mr. Hagemann, of Kansas City, and a lot of the most eminent lawyers in the whole United States, had a different opinion from the one finally arrived at by the Supreme Court. It does seem to me that decision works an absolute inequality and injustice. I was appealed to by some of these people who have been hard hit to know whether this committee would not insert a clause at least allowing them to amortize; that is, to pay in installments these back taxes that were created from that decision. The request is that we either do that or change the language of the act so that instead of the taxes being based upon investment they should be based upon value at a given time.

I want to ask the Secretary now, and Dr. Adams, who is here, I suppose, as the expert of the Treasury Department, whether that could not be done; whether one or the other of these two plans could not be adopted. Plainly, this is true: If Senator McCumber had good sense and good judgment and went out and bought a piece of property at a moderate price, that would be his investment. If I should go out and buy a piece of property at a swollen figure, or buy it many years afterwards, my investment would be greater. That is not the test. Senator McCumber ought to pay on the value of his property and I ought to pay on the value of mine.

Senator SIMMONS. May I say to you, Senator Reed, that we threshed out that matter very thoroughly when we passed the first general revenue act imposing excess-

profits taxes? We had to have a basis for the exemption of 8 per cent, and we finally decided that the proper and correct basis was the capital originally invested; that is, the original purchase plus accumulated surplus. That was made the basis of valuation for the purpose of making the deduction of 8 per cent.

Senator McCUMBER. Plus what?

Senator SIMMONS. Accumulated surplus represents the capital investment. The original investment, plus accumulated surplus. That was the basis of it.

Senator REED. I can not imagine anything more inequitable than that.

Senator SIMMONS. We had a good deal of testimony about it. A good many thought you are right, and there was a good many who thought otherwise.

Senator McCUMBER. What was the situation when there was no accumulated surplus?

Senator SIMMONS. There was the original investment.

Senator McCUMBER. In that original investment is the foundation of the inequity.

Senator SIMMONS. That may be, but all I am saying is that was what was determined as the basis of the 8 per cent.

Senator REED. I think the law ought to have required, and ought to require now, that you should take, let us say, the value of the property in 1913. Then if Senator La Follette made a good bargain prior to that, and I made a bad bargain prior to that, paying twice what my property was worth, and he paying half what his was worth, when we come to 1913 the Government takes the value, not what we originally paid.

Senator McCUMBER. That is what was done in the matter of sales.

Senator REED. Yes.

Senator SIMMONS. Yes; that is what was done with the matter of sales.

Senator CURTIS. What do you mean by "value"?

Senator REED. The fair and reasonable market value.

Senator CURTIS. What would you do in a section like ours where in 1913 a piece of farm land sold at from fifty to one hundred dollars an acre, and they afterwards discovered oil and it sold for great sums of money?

Senator REED. That would only be made worse by the other rule. The other rule would go back to the fellow in your State who bought at a dollar and a quarter an acre.

Senator CURTIS. It is so bad they would not sell a lot of oil property, because it would take it all for the tax.

Senator REED. My rule would mitigate that. It is said that Manhattan Island was once sold for a barrel of whisky. Suppose that original purchaser still owned Manhattan Island. Would you want to tax him on the difference between his barrel of whisky and what it would sell for now? Suppose he sold half of it last year?

Senator McCUMBER. Measured by the present value of the whisky?

Senator REED. I suppose if he had the barrel now he might get it back. But, joking aside, you see the inequity of it. These people have appealed to me to know whether, having closed their books on the opinions of these lawyers and having relied upon them, they would be permitted by some amendment in this bill to pay this back tax in installments.

Senator CURTIS. What objection would there be to that, Mr. Secretary?

Secretary MELLON. It seems equitable. I do not see that there can be any objection to it. Of course, in a lowing that to be paid in installments reduces the surtax—no; that is the corporation tax. There is no reason why that should not be done, so far as I can see.

Senator WALSH. They seem to get a big revenue from that.

Senator REED. I think there is a good deal of revenue.

Senator WATSON. Your proposition does not affect the payment of revenue.

Senator REED. It affects the back taxes that might be collected, but does not affect the aggregate for the year.

Secretary MELLON. While they are extreme cases, the number of cases of that sort is not so very large now. I do not think we could estimate what it would amount to, but I do not think it would run into a very great aggregate amount.

Senator REED. For instance, a gentleman came to me whom I know very well and said he had a client, giving me his name, who had closed his books and done his business on the basis of what he supposed the law was; that his back taxes were $500,000; that he absolutely, although solvent, could not go and borrow that amount, but he could pay part of it and was willing to pay part of it, although he thought the law somewhat unjust.

Senator WALSH. I understand the Supreme Court sustained the opinion which the revenue department had promulgated, and the only people who suffered were the people who contested the opinion and acted upon advice outside of the revenue office.

Senator REED. I think that is true.
Senator WALSH. Not very many of them.
Senator REED. I think not. The Secretary has said he sees no particular objection to it. At the proper time I will prepare an amendment, or I would like to have Dr. Adams, who is more familiar with these matters, prepare one. I suppose you would not draw it yourself, Mr. Secretary.
Secretary MELLON. No.
Senator REED. I would like to have Dr. Adams prepare an amendment which will be technically accurate and cover this question, and we will submit it to the committee.
Dr. ADAMS. That is a provision for the collection of back taxes in installments merely in these cases, or generally?
Senator REED. In these cases.
Senator WALSH. Senator Smoot, are you satisfied that the expenses of the Government for the coming year will be what the Secretary of the Treasury stated?
Senator SMOOT. If there are $500,000,000 saved from the appropriations, as stated by the Secretary, we will raise it.
Senator WALSH. What do you think of the suggestion of Senator Reed that we modify our appropriations?
Senator SMOOT. I do not believe the Secretary of the Treasury can tell you what those expenditures will be.
Secretary MELLON. We gave very great attention to our estimates, taking into consideration all items.
Senator SMOOT. And you did that, Mr. Secretary, by saying something like this: "The Navy Department has so much appropriated to them. We want them to cut it so many dollars." But if you come to repeal the amount of any estimate that they have not expended, you have to go into the law and take every item and take the percentages of that, and you can not do it.
Secretary MELLON. But the Navy Department and the War Department went over the items of expenditures and made their calculations as to whether they could make those cuts, and they all agreed to make them.
Senator SMOOT. I was speaking of the proposition that we ought to go to work and repeal $500,000,000 from the appropriations that have been made. That can not be done, Mr. Secretary.
Secretary MELLON. But the result would be the same.
Senator SMOOT. Oh, yes; you can say it would be the same.
Secretary MELLON. Of course we are predicating our estimate on their position that they can get along with the amount they have agreed to get along with.
Senator SMOOT. If they do not save the $500,000,000 I want to say to this committee we will fall short of the revenue to pay the expenses of the Government.
Senator WALSH. I think it is a very bad precedent.
Senator MCCUMBER. What is a very bad precedent?
Senator WALSH. To raise revenue upon a private understanding with the heads of departments as to how they are going to expend their appropriations.
Senator MCCUMBER. The departments make their estaimates. They made their estimates in October for the next fiscal year. Suppose they get together again and say, "We can cut that a little bit and make it a little less." Instead of making a further report they make an estimate of what they can possibly cut that down. Can you see anything unjust or wrong about that?
Senator WALSH. Would you recommend to every city and State such a method as that?
Senator MCCUMBER. Yes.
Senator WALSH. That they raise their revenue based upon the amount which the private heads of departments agree they will spend?
Senator MCCUMBER. If I thought they would keep within their agreement I certainly would recommend that the tax be reduced to meet it.
Secretary MELLON. There is further now the Budget Department, which keeps currently in touch with these departments and keeps an accurate budget of what they are currently expending, to see whether they are expending the amounts appropriated to them, and I think with that they can keep the matter within bounds of what has been agreed upon.
Senator WALSH. I think that is most commendable, but I think the practice of seeking to raise revenue based upon the amount that heads of departments will say they will expend is very dangerous and very bad.
Senator MCLEAN. Do you know how far the economies of the Government have been put in operation up to date?

Secretary MELLON. I do not know. I know those departments made their calculations and went into the items of expenditure and estimated they could cut out expenditures to that extent without injury to the service.

Senator MCLEAN. Have they already begun to operate these economies by retiring employees and saving money wherever they can?

Secretary MELLON. Exactly.

Senator MCLEAN. How long has that been in operation? How long since they begun that?

Secretary MELLON. It has been a month.

Senator MCLEAN. Long enough so that you can fairly assume that this money will be saved?

Secretary MELLON. I think we can fairly assume it.

Senator REED. Then the various heads of departments, if I understand you, when they met with the President, submitted schedules showing where and how they could make savings? Is that correct?

Secretary MELLON. They made their calculations and their own estimates of how those savings could be made.

Senator REED. Where is the detail of that information?

Secretary MELLON. The detail of it would be with the departments.

Senator REED. Did you make an estimate for the Treasury Department of the savings that you could make in that department?

Secretary MELLON. Yes.

Senator REED. Would you object to giving us that estimate?

Secretary MELLON. No; I do not have it with me.

Senator REED. I mean send it to the committee.

Secretary MELLON. I will be very glad to do so.

Senator REED. Mr. Chairman, I move that we ask the various heads of these departments to send to the committee for its use, confidential or otherwise, I do not care, the various estimates that they made in the items of savings. In that way we can get at it.

Senator SMOOT. I think there is another way of getting at it, Senator, if I may be allowed to call your attention to it.

On page 3 of the report referred to by Dr. Adams, laid upon the table for each Senator, you will find the classifications of estimated expenditures for the fiscal year 1922—that is 1921 and 1922, I take it. It is the Secretary's letter to the Ways and Means Committee of the House. Of course, if you take those items like the item for the Agricultural Department, and take that from the amount actually appropriated that will show the saving of the Agricultural Department, and so on down the line.

Senator REED. But it does not show the items.

Senator SMOOT. No; it simply shows the amount.

Senator REED. That is what I am trying to get at.

Mr. Chairman, let us say the Navy Department reports that it can cut its estimated expenditures by $300,000,000. I want to know how they make that cut. Are they able to do it because some ships are not to be built, some boats are not to be constructed, or that the personnel of the Navy has been cut down? How is that arrived at? I think we ought to have those estimates furnished to us by each department. I do not care whether they are made public or not, but I would like to see them.

Senator CURTIS. Let them be sent to us confidentially, and if the committee wishes to make them public afterwards they can do it.

The CHAIRMAN. Have they not been furnished already? How is that, Senator Smoot?

Senator SMOOT. The budget report for the next fiscal year. Senator Reed is referring to the fiscal year 1921-22.

The CHAIRMAN. Not to 1923?

Senator SMOOT. Not to 1923. The cuts that we are trying to provide for are from the appropriations that were made for the fiscal year ending June 30, 1922. That is the present fiscal year.

The CHAIRMAN. I understand.

Senator REED. I made the motion that the heads of departments be requested to send their detailed estimates to the committee.

Senator SMOOT. I do not know that they could do it in detail, but they might do it as much in detail as is practicable.

Senator REED. As detailed as they can make it.

The CHAIRMAN. Suppose that in some of the departments a deficit is likely to be encountered.

Senator SMOOT. All they will have to report is that there is no saving.

Senator REED. If there is going to be a deficit they ought to report that.

Senator SMOOT. They can not tell that.

Senator SIMMONS. Senator Smoot, have you there conveniently the date of the passage of the last general appropriation bills?

The CHAIRMAN. Excuse me, gentlemen.

Senator Reed, will you address a letter to me asking for the information covered by your motion, and indicate in it what you want, and I will send it to the heads of the departments?

Senator REED. I will do that.

Senator SMOOT. Answering your question, Senator Simmons, I will say that the small appropriation bills were passed in 1920 and the six large bills were passed in 1921.

Senator SIMMONS. What time in 1921?

Senator SMOOT. After March 4.

Senator SIMMONS. After March 4, 1921?

Senator SMOOT. Yes.

Senator SIMMONS. So that the big appropriation bills that you say now appropriated more money than these departments will spend have been passed since March 4?

Senator SMOOT. We got the estimates they made before that.

Senator SIMMONS. I understand that. You had the estimates before you when you made those appropriations?

Senator SMOOT. Yes.

Senator SIMMONS. You discounted the estimates?

Senator SMOOT. Yes.

Senator SIMMONS. You reduced them all you could?

Senator SMOOT. We thought we did.

Senator SIMMONS. Now, the Senator from Connecticut said a little while ago that probably these departments had found out that they could cut off from their personnel. When you made that appropriation and the Committee on Appropriations passed on the amount, did you not then consider the possibility of reducing the force?

Senator SMOOT. They did, as far as the Army and Navy appropriation bills were concerned. The others, of course, were passed upon the testimony that was secured by the Appropriations Committee as to what actual cuts should be sustained.

Senator SIMMONS. You considered possible cuts?

Senator SMOOT. Yes. I will say we cut even more than the heads of the departments at that time claimed they could be cut.

Senator REED. Who were the heads of the departments?

Senator SMOOT. I do not mean the heads of the departments. They hardly ever appear before the committee.

Senator REED. Their representatives?

Senator SMOOT. Their representatives.

Senator REED. That all happened after March 1?

Senator SMOOT. The hearings were held before March 1, with the exception of the Army and Navy, and those two went over until after March 4 and they were passed after that time, and at the time the amount of personnel in the Army and Navy was reduced.

The CHAIRMAN. The wastage occurred before March 4?

Senator SMOOT. Yes.

Senator SIMMONS. That has nothing to do with this question. The question that the Committee on Appropriations decided was how much it would take to run the departments, carrying out your large program of retrenchment and reform and economies and all of that, and you required them to cut it to the bone. Your appropriations did not include the whole of the estimated amounts, but included only such parts of the estimated amounts as you, from your thorough investigation, felt would be absolutely necessary to cover the expenses of the particular departments concerned.

Senator SMOOT. Based upon the testimony that we had.

Senator SIMMONS. And that has been since March 4?

Senator SMOOT. No.

Senator SIMMONS. You said the big appropriation bills were passed since March 4.

Senator SMOOT. The Army and Navy bills were the big appropriation bills, and they were passed since March 4.

Senator SIMMONS. The deficiency bills and all those have been passed since March 4.

Senator SMOOT. Two deficiency bills. We had four or five before that.

Senator SIMMONS. The sundry civil and the Army and Navy?

Senator SMOOT. Yes.

Senator WALSH. I understand the Secretary of War appeared before the Military Affairs Committee and made a new estimate upon which you based your appropriation bill.

Senator SMOOT. Oh, certainly.

Senator WALSH. In which reductions were made in his original estimate?

Senator SMOOT. Yes. At the time they cut the Army down from 225,000 to 175,000 that automatically cut down the appropriations, in the very bill when the vote was taken upon the size of the Army and Navy.

Senator SIMMONS. The position we are putting ourselves in right now is that we have appropriated $500,000,000 more for these departments than is absolutely necessary for them to spend.

Senator REED. I do not think you can put it in that way.

Senator SIMMONS. And we are going to raise taxes to pay the expenses of the Government, and going to raise $500,000,000 less taxes than the amount we have appropriated, and recently appropriated, as absolutely necessary to pay the expenses of these departments

Secretary MELLON. Not under the bill you have before you. We have taken into consideration these reductions.

Senator SIMMONS. I understand that. You say these appropriations are $500,000,000 in excess of what they should have been, in excess of the amount found by the committees of the two Houses to be necessary to defray the exposes of the Government.

Senator SMOOT. If you will confine that to the bill as it passed the House then you are right, but when this bill passed the House they passed it with the understanding there was going to be a saving in the appropriations made. I still believe, if we pass the House bill just as it is now, no matter what saving we may make, we will be so close to skating on the thin ice that it will be a very dangerous proposition to do it, because ever since I have been a member of the Appropriations Committee, even when we were appropriating money with no particular idea of saving, there never has been a fiscal year that there have not been deficiency appropriations, and there never will be.

Senator SIMMONS. There has not been since I have been here, and I agree with you, but instead of that you now say that the Congress has appropriated this amount of money, something like $500,000,000, more----

Senator SMOOT (interposing). No.

Senator SIMMONS. How much is it? That is what you say will be the saving.

Secretary MELLON. You have not come out to the wrong every year.

Senator SMOOT. No; I do not say that, Mr. Secretary, because of the fact that we had to provide some revenue from other sources. Not only that, but in the past the question of how to raise revenue was not so potent as it is to-day.

Senator SIMMONS. If I understand the Secretary, if we are to provide income to meet our appropriations and expenses of the Government as contemplated at the time these appropriations were made, we will have to raise $500,000,000, or approximately that amount more than he says we will need. Does not that mean, if it means anything, that we have provided for the payment of $500,000,000 more than the Government will need, according to the estimates made to you by the department?

Senator SMOOT. I wish that had been stated in a direct way and confined to the amounts that have been appropriated. This is the way the statement is: That the total estimated expenditures of the Government were $4,500,000,000. We have not appropriated that amount of money.

Senator SIMMONS. I understand that.

Senator SMOOT. But now they say with that estimated amount of expenditure of money they are going to save $500,000,000 in round numbers.

Senator SIMMONS. What is the estimate, Senator Smoot, upon which they ask us to provide funds? It is the appropriation, is it not, fundamentally?

Senator SMOOT. The appropriations are not taken into consideration.

Senator SIMMONS. They estimate that these departments will need how much—$300,000,000?

Senator SMOOT. $4,000,000,000.

Senator SIMMONS. How much money do they estimate the departments will need less than the amounts we have appropriated for them?

Senator SMOOT. They do not say that.

Senator SIMMONS. That is what I want to find out.

Senator SMOOT. They say they need nearly $500,000,000 less than the estimated amount of expenditures. They are talking of the estimated amount of expenditures, and we are trying to figure it uopn the actual appropriations.

Senator WALSH. Do they estimate they are saving anything on the appropriation?

Senator SIMMONS. That is what I am talking about. How much do you estimate we will save on the appropriations actually made?

Secretary MELLON. I do not see how you can say that. There are all kinds of appropriations, and I do not see how you can take that into consideration.

Senator SIMMONS. Can you not determine how much less the War Department now says they will need than the amount appropriated for them? Can you not do the same with the Agricultural Department, the Navy Department, the State Department, and all the departments? You say that this saving you are talking about is the result of a conference between the heads of the departments and the President of the United States, in which statements were made to the President that they would be able to cut their expenditures down below the amount appropriated. Now, this committee ought to know exactly how much less money each department now claims it actually requires than the amount that was appropriated.

Secretary MELLON. That is all shown in this statement.

Senator SIMMONS. How much is it, Mr. Secretary? That is what I want to find out.

Senator WALSH. $520,000,000.

Senator SIMMONS. $520,000,000. The departments will need that much less than we have appropriated. That is what I said at the beginning.

Senator LA FOLLETTE. The Secretary has not answered that. He has not stated that, although a member of the committee has.

Secretary MELLON. I do not know that I understand what appropriations you are speaking of.

Senator SIMMONS. I am speaking of the appropriations that have been made. You said there was an agreement between the heads of the departments to effect that saving. I assume, therefore, that in that conference where that agreement was made each department advised the President how much less money it would need than had been appropriated for it.

Secretary MELLON. Yes; how much less than the estimate had been.

Senator SIMMONS. I am not talking about the estimate; I am talking about the appropriation.

Senator REED. Let me ask this question: When this meeting was held in the President's office, and when the agreement to make reductions which aggregated $500,000,000 was made, was that a reduction from the estimates they had made or from the amount Congress had appropriated?

Dr. ADAMS. Senator, may I answer that question?

Senator REED. Yes.

Dr. ADAMS. All right. You have all got to come back to the fundamental truth that it is expenditures that control the Treasury situation. The appropriation for this fiscal year were $3,960,000,000. The departments came in originally saying that they would expend $4,550,000,000. What does that mean? It can only mean one thing—that they have prior appropriations, available balances, which make that possible. The $350,000,000 which is spoken of is largely savings from prior appropriations.

Senator WALSH. Unexpended balances?

Dr. ADAMS. Unexpended balances. The controlling figures are not necessarily the appropriations for this year. The controlling factor is how much is available from prior appropriations and present appropriations.

Senator SIMMONS. Doctor, was not all this considered by the Appropriations Committee?

Senator SMOOT. If the doctor will permit me, so you will know how that was——

The CHAIRMAN. Could not Dr. Adams be permitted to answer it?

Dr. ADAMS. I want to say that I do not think that question can helpfully be discussed altogether in terms of how much the departments need. There is in this connection a very important element of departmental policy as to expenditures. For instance, at one time, I think I can state with safety, the War Department had available prior balances of nearly a billion dollars.

Senator SIMMONS. Dr. Adams, on this question of unexpended balances, when they came to the committee and asked for additional appropriations they included in their demands, or you considered the fact, that they had this unexpended balance, did you not?

Dr. ADAMS. In some cases, and in some cases not.

Senator REED. That leaves the committee in fine condition. In some cases they do and in some cases they do not, and we do not know in which they did and in which they did not, so we do not know how much money we are to get.

Dr. ADAMS. I would like to finish my statement.

Senator SIMMONS. At the time the Appropriations Committee acted, if they did not expect the War Department to utilize that unexpended balance, they should have repealed it and had it covered back into the Treasury. Their appropriation must have been based upon the idea they were to be permitted to use it.

Senator CURTIS. In some cases we made a continuing appropriation, to be used until expended. In some cases we had a revolving fund of so many hundred thousand

dollars that can be expended, and as it comes in they can keep on spending it. We never bothered about those things. Then we would have an appropriation that expired July 1, in which there was an unexpended balance. We had some appropriations that we made back in 1919 in which there were unexpended balances of a few hundred or a few thousand dollars. We had one case of about $100,000, and in the bill we authorized them to use that balance from 1919. We passed on the unexpended balances that would go back into the Treasury the 1st of July. If the appropriation is a continuing appropriation, that does not have to be brought to our attention and we make no reference to it. It goes right on until it is expended.

Senator SIMMONS. And when they secured more money to pay their expenses for the next year they always considered that balance?

Senator CURTIS. If it is an item that we have to consider. It may be one we have to consider, and it may be one we would not consider. Some we do not consider at all, and some we do consider. They make a report showing what they have done with it, and that is the end of it, until they want more money. Some of the heads of departments came in and put their cards on the table and showed us just what they needed and just what they could get along without, and we got along nicely. Some of them came in that we could not get information out of with a corkscrew.

Senator WALSH. You should not have given them anything.

Senator CURTIS. We had to give them something. The departments had to run.

Senator SMOOT. Answering Senator Simmons, if you are through, Dr. Adams——

Dr. ADAMS. I wanted to make one other point, and that is the very important element of policy in these expenditures when prior appropriations are available, which may change the existing condition. For instance, we will say that in the last year there was a prior appropriation of $184,000,000 available for expenditure for good roads. The Department of Agriculture may properly say, "Business being bad, if we can relieve the situation by expending $25,000,000 less than we thought we would spend six months ago when we first turned in our estimates," that is not a thing to be criticized. There are certain kinds of appropriations in which the department head must have some discretion as to when he shall spend it, and he may exercise that discretion in view of the condition of business and the demands of taxation.

Senator SIMMONS. That is very pertinent. If the Secretary of Agriculture promises the President that he will spend less money for good roads than Congress has appropriated for good roads, it is very important to know that.

Dr. ADAMS. I do not know about that.

Senator WALSH. I understand that by adding the appropriations to the unexpended balances, less the present estimates of the departments, they will save $500,000,000.

Dr. ADAMS. No; I could not say that. I can not tell you what those available appropriations are.

Senator WALSH. Unexpended balances covering everything.

Dr. ADAMS. The departments originally estimated they would require $4,550,000,000. Later when they realized the condition of business and the real necessity for lower taxes, they said that in the exercise of sound discretion they would spend less.

Senator WALSH. The maximum limitation there may be the appropriations plus the unexpended balance, or may be less than the appropriations plus the unexpended balance?

Dr. ADAMS. I should say, in general, it was the appropriations plus available balances from prior appropriations.

Senator WALSH. What do you say, Mr. McCoy? You are shaking your head.

Mr. MCCOY. As Dr. Adams said, the whole thing, from the Treasury standpoint, is expenditures. We have nothing to do with the appropriations. The Treasury has to do with expenditures. They estimate certain expenditures that must be met. Realizing the absolute need of the country for money, they cut to the bone their expenditures. It hurt. They absolutely needed the money, but in consideration of the taxpayer they did cut, and that is where that cut comes from. It is not to cut something they could do without. It is something that hurts them, but they do without it.

Senator MCLEAN. Then the unit upon which you make your subtraction is your own estimate of expenditures?

Mr. MCCOY. The estimate of expenditures of the other departments, together with the Treasury Department.

Senator REED. You say they cut to the bone and took out money they really need. One item of that was good roads, was it?

Mr. MCCOY. I do not know that.

Senator REED. Let us assume one item is good roads, and Congress appropriated $100,000,000 for good roads. Now, the Secretary of the Treasury says $25,000,000 of

that he will not expend, and that is charged up as a saving to the Government and a saving to the people.

Mr. McCoy. Not exactly a saving, but not an expenditure.

Senator Reed. It is a reduction.

Mr. McCoy. It is a reduction.

Senator Reed. In other words, all you have done is to stop the expenditure of a certain amount of money which was to go into a public improvement for the benefit of the country and was supposed to be worth every dollar that was invested. You could save the whole hundred million dollars by not spending, but the good-road building would stop.

The Chairman. That does not follow.

Secretary Mellon. May I just say that for the purpose of raising the amount of revenue required the Treasury takes the best available information we could get? I was present at most of the interviews with the heads of departments, etc., and we believed that the amount of money that had been agreed upon would be the amount that would be used by these departments. So that we have made our estimate on that basis, which makes a total of $4,034,000,000. I think we can fairly assume that they will go along on that basis.

Senator Reed. I understand that is the Treasury's position.

Secretary Mellon. Yes.

Senator Reed. I was only trying to trace out what might be some of the methods of the saving, and one of the methods which might be employed is to not do something which Congress contemplated should be done.

Senator Smoot. Take the good roads bill. An appropriation is made and the amount specifically stated in the bill as to how much should be expended each year. That was brought up as an illustration, but it does not apply to the law, because the law says there shall be so much money expended every year.

Now, answering the question of the Senator, if nobody else wants to talk——

Senator Reed (interposing). Let me follow that for a moment. Take the question of the rivers and harbors program. A lump sum was appropriated for rivers and harbors. Now, of course, they could save the entire lump sum by not carrying on the work, but the country would not have the benefit of the work.

Senator Smoot. That is covered by contracts that have been made. I think all of the appropriations for rivers and harbors have been contracted for.

Senator Simmons. I think before we go any further on this line we should know exactly the items of these savings. I think we should know first how much the War Department proposes to save or cut off in this way, and what that saving consists of, how it is going to affect the service, whether it is going to cut the service down in a way Congress does not want it cut down.

Senator Smoot. You asked a question that it seems to me the answer would solve this whole problem in the minds of the committee.

Senator Simmons. I would be very glad to have an answer to it.

Senator Smoot. Speaking of unexpended balances, you asked whether they had been repealed or not by the Appropriations Committee. In the fortifications appropriation bill we repealed about $100,000,000 of unexpended balances. In the War Department at one time we repealed over a billion dollars of unexpended balances, but in this last appropriation bill where we did repeal a number of them I was chairman of the subcommittee, and we asked Gen. Lord to come in. We took every unexpended balance in the appropriations that had been made for the War Department for every purpose and we said: "Gen. Lord, why can we not repeal the total amount of this appropriation?" In some cases he said: "You can not do it, because we have contracts out, and those contracts must be completed and the money must be paid when they are completed." We said "How much does that amount to, Gen. Lord?" He would state the amount. Then he would say: "There are certain contingencies that we must have money on hand, in order to meet them, or else it may be a detriment to the War Department and the service." "How much is that?" and he would state the amount. We went over every item and Gen. Lord cut out everything he thought he was safe in cutting out at that time, and we repealed that amount of the appropriation.

There is no doubt but what with the appropriations we have made of $3,960,000,000, with the unexpended balances, that this administration could expend more than $4,500,000,000, because in all the departments there are unexpended balances amounting to more than that difference. What they have figured is this: They have figured that they will take all the appropriations that have been made, $3,960,000,000, and the estimated expenditures over and above that would be about $440,000,000 to be paid out of the unexpended balances. They say: "We will not spend that amount of money. We are going to cut it down." A part of that cutting comes out

of the amount that is appropriated here, and no doubt they will cut a good deal out of that that is covered now in the unexpended balances. They do not have to come to Congress and ask to spend these balances that have been appropriated, not within the fiscal year.

Senator SIMMONS. I understand that, but you have just said that you repealed all the unexpended balances.

Senator SMOOT. Oh, no; I did not say "all."

Senator SIMMONS. Let me finish. You repealed the unexpended balances of the War Department, except as to certain amounts for which contracts had been made?

Senator SMOOT. And certain amounts that they always wanted and had to hold as an unexpended balance for unseen items.

Senator SIMMONS. If they always had to do it, why will they not have to do it this time?

Senator SMOOT. I suppose they have decided here they are going to cut out everything that is possible to cut out. Part of that cutting will be made and taken out of some of these appropriations, and the balance will be taken out of these unexpended balances, but taking the two together, that is the way they figured they are going to make that cut.

Senator SIMMONS. I want to follow out your statement about the War Department. You repealed all those unexpended balances, except certain amounts that you say had been contracted for and certain amounts that they always retained for the purpose of meeting contingencies?

Senator SMOOT. Yes.

Senator SIMMONS. Now, when you come to the rivers and harbors bill you can get along with a lump-sum appropriation, because there is a large unexpended balance?

Senator SMOOT. $80,000,000.

Senator SIMMONS. That has been appropriated for certain projects that are now under development?

Senator SMOOT. Yes.

Senator SIMMONS. Now, you did not repeal that appropriation because that has been appropriated for these particular projects. In nearly every instance it was developed that contracts had been made that would cover these unexpended balances. They can not use them for other purposes any more than they could in the case of the War Department.

Senator SMOOT. I do not think they could.

Senator SIMMONS. Coming to good roads, we asked for $100,000,000 appropriation. We were told, "There is now an outstanding appropriation of $130,000,000 for good roads which is unexpended." We answered that by saying that the bulk of that had been contracted for. Where a contract has been made the department can not possibly utilize that unexpended balance.

Senator MCCUMBER. Mr. Chairman, if you will allow a suggestion, while this is very interesting and may be pertinent to the matter really under discussion, we are really here to-day to get suggestions from the Secretary of the Treasury rather than to argue out what we intend to do on these questions, and I wish we could get those suggestions.

The CHAIRMAN. I hesitate to express an opinion. As long as the committee is willing to permit this endless discussion to continue I do not intend to say anything, but I entirely agree with Senator McCumber. We are here to hear from the Secretary, and later behind closed doors we can continue this discussion.

Senator SIMMONS. I think the Secretary has made a statement of tremendous importance, that we can get along with less than we thought we could get along with a few months ago. I think we should take time to find out exactly how that legerdemain is to be accomplished.

The CHAIRMAN. But, Senator Simmons, we have been three-quarters of an hour debating among members of the committee questions only incidentally connected with the issue.

Senator SIMMONS. I think they are vitally connected.

Senator MCCUMBER. The motion of the Senator from Missouri, asking that certain data be furnished, I think should be passed upon.

Senator REED. I think it was impliedly passed upon. The chairman asked me to write him a letter, stating just what data I wanted, and said he would take it up with the heads of departments.

Now I offer this suggestion: I think this discussion of Senator Smoot and Senator Simmons and other members of the committee was necessary in order to get a clear understanding, so that we may really know what the facts are. I do not think it is a waste of time, but I presume we are through with it. It has been very illuminating to me.

Senator SIMMONS. Let us hear the Secretary without any further discussion, if it is intended to foreclose the discussion.

Senator McLEAN. I want to call attention to the appropriation for good roads. If it is found there is to be an economy and a certain saving, I think the committee would like to know how it is to be accomplished. For instance, can the department having that fund in charge decline to expend a certain portion of that appropriation which Congress has authorized for this year?

Senator CURTIS. That was only used, Mr. Chairman, as an illustration.

Senator SIMMONS. It is a very important one.

Senator McCUMBER. I think the Secretary can answer that if he is given a chance.

Secretary MELLON. You will receive that information under the request to the departments for the items. Whether it is pertinent in some instances to good roads or not can be determined from that.

Senator SIMMONS. That is the reason I think we should have it itemized.

Secretary MELLON. But for the purposes of the bill, we have the amount that we expect will cover the expenditures for the fiscal year, say 1922. From the available information that we can get, that is the amount required, $4,034,000,000. It seems to me we can safely take that as the amount that is going to be required.

Senator LA FOLLETTE. Is it not possible—after having gotten this itemized statement of the savings it is expected the departments are going to make, which will have a direct bearing on the amount we are raising by taxation—that Congress might not agree with the departments that those savings should be made; that Congress might take the view that it was in violation of law; that the appropriation had been made to be expended for a purpose? Some of this discussion and the information which has come out as a result of it seems to me is very pertinent and something we should hear.

Secretary MELLON. That is all the information we had before us.

Senator LA FOLLETTE. Can we start with the assumption that there is only a certain amount to be raised, when we do not know but that more will have to be raised?

Secretary MELLON. That is the amount from all the available sources we had to gain our information from.

Senator LA FOLLETTE. Yes; but it takes into account certain savings that you gentlemen, members of the Cabinet, have proposed that you can make. We do not know whether you can make them or can not make them, and we do not know what they are. We do not know whether you have a right to make them or not. I think they should come before the committee fully itemized.

Senator McLEAN. Mr. Secretary, on page 7 of your letter of August 4 to the Ways and Means Committee you state that this revision is made upon certain estimates. Among those estimates you anticipate an increase of the tax on cigarettes and smoking and chewing tobacco. Later on you anticipate a material increase in the stamp tax.

Secretary MELLON. It should be understood that at the time that was before us those things were under consideration, but it was all changed by the action of the Ways and Means Committee and of the House, so that you might regard it as the House bill before you.

Senator McLEAN. That is what you are considering now?

Secretary MELLON. Yes.

Senator McLEAN. And your estimate is really based upon the bill as presented to us?

Secretary MELLON. Yes.

Senator WATSON. Mr. Secretary, that does not take into account the repeal of the excess-profits tax retroactive to January 1, 1921?

Secretary MELLON. As the bill is before you, it does not.

Senator WATSON. Suppose we should pass that proposition, what cut would that make in the revenue?

Secretary MELLON. Then it would be necessary to make other changes to supply the revenue that would be lost.

Senator WATSON. About $450,000,000?

Secretary MELLON. I do not think it would be that much.

Senator WATSON. What is your estimate of it? What is your estimate, Mr. McCoy?

Mr. McCOY. For the fiscal year it would not be that much. There would be two payments in the present fiscal year included, whether you repeal it as of January 1 1921, or not.

Senator WATSON. How much would it be?

Mr. McCOY. $230,000,000 or $240,000,000.

Senator WATSON. Suppose the committee would decide to do that, how would you make up that difference, Mr. Secretary?

Secretary MELLON. The suggestion that we would make, if that excess-profits tax is to be eliminated as of the first of this year, would be to increase the corporation income tax to 15 per cent, instead of 12½, that is estimated here.

Senator WATSON. What would that amount to?

Secretary MELLON. That would amount to about $150,000,000.

Senator SIMMONS. Would you make that amendment retroactive?

Secretary MELLON. Yes.

Senator SIMMONS. That would begin in January, 1921?

Secretary MELLON. For the current year.

The CHAIRMAN. Mr. Secretary, did you recommend or did your department recommend the elimination of the excess-profits tax as of January 1, 1921?

Secretary MELLON. That was our recommendation to the Ways and Means Committee.

The CHAIRMAN. Do you still adhere to that recommendation?

Secretary MELLON. Well, it is a very unsatisfactory tax in a way, and is inequitable, and ought to be repealed. Of course, if it is a question of revenue, and it is not deemed desirable to place the amount elsewhere, it will have to be retained; but it is a tax that should be repealed.

Senator WATSON. For that purpose, I was asking from what other source of revenue we could make up that difference. You say an increase in the corporation tax from 12½ to 15 per cent. What else?

Secretary MELLON. Then the transportation tax, which under the bill is eliminated, would be reduced, beginning the 1st of January, 1922, one-half instead of being entirely repealed.

Senator REED. You mean the tax on railroad transportation?

Secretary MELLON. Yes. Under the bill that was eliminated from the 1st of January, 1922. It will be necessary to do as we originally recommended; that is, to cut that one-half at that time and then in 1923 abolish the other half.

Senator SIMMONS. You eliminate the transportation tax for this calendar year?

Secretary MELLON. One-half the rate.

Senator WATSON. Would that amount to $150,000,000?

Secretary MELLON. Somewhere near that.

Senator REED. Senator Watson, are you through with your line of questions?

Senator WATSON. No. I want to find out whether or not you intend to make a recommendation for an increase of postage and stamp tax, and how much each of those will add to the revenue, if those recommendations are to be made to take the place of the repeal of the excess-profits tax retroactive to January 1, 1921.

Secretary MELLON. My recommendation would be to increase the documentary stamp tax, but in the House that seemed to be objectionable and did not seem to be likely to have favorable consideration.

Senator CURTIS. Mr. Chairman, if the Secretary has a statement would it not be better to let him read it and then ask him questions afterwards?

The CHAIRMAN. I understand he has no statement.

Senator REED. Just for the sake of getting this clear in my own mind, what is it you estimate you will get from the excess profits tax during the year?

Secretary MELLON. About $660,000,000.

Senator REED. That would be for the fiscal year beginning in June of 1921 and ending in June of 1922?

Secretary MELLON. Yes.

Senator CALDER. Ending December 31 of this year?

Secretary MELLON. No; the fiscal year.

Senator REED. You recommend that the excess-profits tax be wiped out, and the House has wiped it out in this bill. When does that repeal take effect?

Secretary MELLON. The 1st of January, 1922, under the House bill.

Senator REED. Next January?

Secretary MELLON. Yes.

Senator REED. So we are to lose by that how much money out of the $669,000,000?

Secretary MELLON. We would be losing about $450,000,000 for the first full taxable year.

Senator REED. You are losing for the calendar year how much?

Secretary MELLON. $450,000,000 I believe it is.

Senator REED. $450,000,000?

Secretary MELLON. Yes.

Senator REED. For the next calendar year beginning January 1, 1922?

Secretary MELLON. Yes, that would be the calendar year 1922.

Senator REED. Beginning with January 1, 1922, and ending with December 31, 1922. Is that right?

Secretary MELLON. Yes, for the calendar year.
Senator REED. $450,000,000 from excess profits?
Secretary MELLON. Yes.
Senator REED. If we have that figure right, it is now proposed to stop the collection of that tax, out of which we are getting $450,000,000 in round numbers, and you say it ought to be stopped and the tax ought to be collected elsewhere. The excess-profits tax does not begin to accrue until the concern has made what profit?
Secretary MELLON. Eight per cent.
Senator REED. Net?
Secretary MELLON. Net, yes.
Senator REED. If you take $450,000,000 of a burden off the concerns that have made more than 8 per cent net, you must collect that tax from concerns that have made less than 8 per cent, including, of course, those that make more? You transfer the tax from those who have made excessive or high profits to those who have made low profits, do you not?
Secretary MELLON. That tax bears more heavily upon the smaller corporations than it does upon the large corporations, because the large corporations as a rule do not make as large percentage of profit as the others make. In other words, they have a larger invested capital, and therefore concerns like the United Steel Corporation and other large corporations do not have the large percentage in relation to their invested capital, because their invested capital is large; but the excess-profits tax is inequitable, because most of the corporations that have that to pay, that have the large excess profits, are small corporations with small invested capital.
Senator REED. They are, nevertheless, corporations that have made more than 8 per cent.
Secretary MELLON. But you can see from this table here their relation, and the large percentage made by the small corporations.
Senator REED. Yes; but nevertheless, whether they are small or large, they are institutions that have made more than 8 per cent?
Secretary MELLON. Yes.
Senator REED. Now, let us go back a moment. This La Belle Iron Co. case, which fixed the excess profits upon the invested capital instead of upon the actual value, and a number of concerns like the Steel Trust, that were formed by taking over at fabulous prices a lot of subordinates, would carry those fabulous prices into their capital, and therefore it would be very hard to reach the Steel Trust and arrive at its excess profits, because its capital is badly swollen.
Secretary MELLON. That is an illustration of the inequity of the excess-profits tax.
Senator REED. Exactly; but if you had based your taxation upon the actual value of the property instead of the invested capital you would get a very different result, would you not?
Secretary MELLON. In some cases.
Senator REED. In many cases.
Secretary MELLON. I doubt very much, when we speak of the amount to be realized from the excess-profits tax, under the present condition of industry, that it is going to be as much as we have estimated, for the reason that I know myself of a great many corporations that are large earners, and were for the last year, and paid for the year 1920 large amounts of excess-profits taxes, that in this current year are not earning that much money and will not be affected at all by this tax, because they are not going to have the earnings.
Senator REED. But, Mr. Secretary, I asked you the question what you estimated you would get, and I assume when you made your estimate you took into consideration all the facts.
Secretary MELLON. The point is this: This is a Treasury estimate, judging from what has been the fact last year what the next will be, under the present condition of the country; but there is no estimate of that kind that can be certain, and we may be very much disappointed, and I think personally we will be. I know of many instances myself where they are not earning at all and will not pay any excess-profits tax.
Senator REED. Nevertheless, that was the best estimate the Treasury Department was able to make, based upon all the information it had, and taking into consideration all doubts which might arise?
Secretary MELLON. Yes.
Senator WALSH. How much less, on that estimate, was collected in the fiscal year, 1919? Can you tell me that?
Secretary MELLON. Two billion less. It has been falling off very rapidly.
Senator MCCUMBER. How much was collected for the fiscal year ending June 30, 1921, the last fiscal year?

Secretary MELLON. About $900,000,000. The year 1920 was a year of large earnings.

Senator MCCUMBER. You are speaking in this case of the calendar year?

Secretary MELLON. Yes, sir.

Senator MCCUMBER. I was wondering what the fiscal year would give us from June 30, 1920, to June 30, 1921. If you have not those figures, it is not so very material.

Mr. MCCOY. The trouble is that the income tax and the excess profits taxes are combined for that fiscal year. We have the total figures. For 1920 the income tax and excess profits tax were $3,957,000,000, and for 1921, $3,226,000,000. That is the income and profits taxes. The Commissioner of Internal Revenue has not yet segregated them. They are unable to segregate them. It is about $1,600,000,000 that has been collected up to the 30th of June, 1921.

Secretary MELLON. If it should be decided here to repeal the excess profits tax and change the House bill, it seems to me that about the following recommendation would cover:

To reduce the transportation taxes to one-half, effective January 1, 1922, and repeal them entirely beginning January 1, 1923, and perhaps also the insurance taxes.

Senator WATSON. How much would each of those items raise, Mr. Secretary?

Secretary MELLON. The transportation tax would raise about $130,000,000, and about $20,000,000 on the insurance, which would make $150,000,000. Then a tax on cosmetics, toilet preparations, and proprietary medicines, section 907, should be restored but imposed upon the producer or importer.

Senator REED. Now, Mr. Secretary: As to proprietary medicines, may I ask you a question?

Senator WATSON. Let us find out how much that is, first.

Senator REED. Very well.

Secretary MELLON. That is a small item. It is about six or seven million dollars, the toilet preparations, etc. It was in that class.

Senator WATSON. You say $150,000,000 for the corporation tax?

Secretary MELLON. You mean, the excess-profits tax?

Senator WATSON. No; your flat corporation tax, when you increase it from 12½ to 15 per cent.

Secretary MELLON. Yes, sir; that is right; about $150,000,000. Then to repeal the excess-profits tax as of January 1, 1921. We estimate on the capital-stock tax, which has been paid for the fiscal year commencing January 1, 1921, but in view of the additional corporation tax to repeal the capital stock tax on corporations——

Senator SIMMONS. If we repeal that, how much would we lose?

Secretary MELLON. In the neighborhood of $80,000,000.

Senator REED. There, again, you increase the tax on these smaller corporations which have small capital stock?

Secretary MELLON. No; that capital-stock tax is not on the small capital. That is on the valuation of their assets.

Senator REED. The capital stock tax?

Secretary MELLON. Yes, sir. The capital-stock tax is on the fair value of the capital stock, taking into consideration their capital and surplus, or their property.

Senator REED. Then the effect of the decision in the La Belle Iron Co. case is this, that when you come to figure excess profits on the steel trust you start with these swollen and fictitious investments which represent an enormous capital stock, and the small corporation, that has a perfectly honest capital stock, you say is hit worse by the excess-profits tax than the steel trust, for the reasons that I have just given. Now you propose to substitute a 15 per cent direct tax——

Secretary MELLON. No, no. The bill as it is before you now provides 12½ per cent.

Senator REED. You are speaking about raising it to 15 per cent?

Secretary MELLON. Yes.

Senator REED. And that tax, when it is levied, is levied not upon the capital stock, not upon the investment that I have spoken of, but upon the actual value.

Secretary MELLON. No; on the actual profits, earnings.

Senator REED. Actual income?

Secretary MELLON. It is an income tax.

Senator WATSON. A corporation income tax.

Secretary MELLON. And it is on the net income.

Senator REED. On the net income do you take out the dividends?

Secretary MELLON. Oh, no; the dividends are part of the net income.

Senator WATSON. I would like to find out what the Secretary desires to recommend in lieu of the tax if we repeal the excess-profits tax retroactive to January 1, 1921. How are we going to make up the difference? I have not yet found that out. I would like to, if I can.

Secretary MELLON. Suppose I give it to you just as I noted it down here.

The CHAIRMAN. I believe it would be well to read it.

Secretary MELLON. Reduce the transportation taxes and perhaps the insurance taxes imposed under Title V of the revenue act of 1918 by one-half, effective January 1, 1922, and repeal these taxes entirely effective January 1, 1923.

Senator WATSON. That amounts to $130,000,000?

Dr. ADAMS. About $150,000,000 with the insurance taxes.

Senator WATSON. The two together?

Dr. ADAMS. Yes.

Senator WATSON. One-half the transportation tax, plus the insurance tax—$150,000,000. Now, what else?

Secretary MELLON. Then, there is the small item of restoring the tax on cosmetics and toilet preparations, etc.

Senator WATSON. That is six millions?

Secretary MELLON. Yes.

Senator WATSON. Then, the increase in the corporation income tax would make a total of $300,000,000?

Senator SIMMONS. Right there, Senator Watson, at the same time that he increases the corporation tax 2½ per cent, he reduces the corporation tax to the extent of the tax on the capital stock, which will amount to $80,000,000.

Secretary MELLON. Let me finish this, please.

To repeal the excess-profits tax as of January 1, 1921, and the capital-stock tax to be collected in the future. That does not affect the present fiscal year. In lieu of those taxes, impose an additional 2½ per cent tax effective January 1, 1921.

Reduce the maximum surtax effective January 1, 1922, to 25 per cent. That would not affect the revenue before the calendar year 1923—and it would not affect it then.

Senator REED. It would not affect it then?

Secretary MELLON. Well, the reduction of those surtaxes would not, in my opinion, reduce the revenue at all——

Senator SIMMONS. But, Mr. Secretary, the House reduced them to 32 per cent. Now, you are going to reduce them to 25 per cent. Will not the margin between 32 and 25 make some difference?

Secretary MELLON. The reason is that there will be more transactions to produce revenue, and therefore the revenue from the lower amount will be at least as much as it would be on the higher surtax, because it catches so many more transactions. Transactions are prevented by reason of the high surtaxes.

Senator SIMMONS. Why, if that be so, do you want to interfere with the House rate? Is it because you think it will increase revenue? Do you want to reduce the surtaxes below the House rate because you think it will increased revenue?

Secretary MELLON. Yes. To begin with, it will increase revenue, and it is of great assistance in allowing the flow of commerce, or, rather, transactions in business which will be released by the lower surtax.

As it is now, for instance, if a man has an investment in securities, in real estate, or anything of that sort, and there is a profit above the value of 1913, if his surtax payment is up to 50 per cent or 40 per cent, and those amounts, it is a bar to the transaction. The transaction is not made and the Government does not get any revenue. But if it is at a lower bracket, he will look at it differently. If it is half that amount he can afford to make the transaction, and the Government gets the 30 per cent or 25 per cent, if it is made 25 per cent. In other words, it brings to the Treasury revenue from great numbers of transactions that are barred entirely by the higher brackets of surtax.

There are hundreds and hundreds of cases all the time where people are prevented from marketing what they have. They are prevented from selling property because if they have the high surtax, the high bracket of all, it would amount to 70 per cent of all the profit they would have made. Therefore it is evident they are not going to make it, that they had better stop where they are in the transaction.

Senator SIMMONS. You think the difference between 32 and 25 would stimulate transactions on which the Government would receive more money?

Secretary MELLON. That is it. It would stimulate transactions. It is the extreme percentage of the tax which makes it unproductive and is a bar to transactions. It is not only a question of revenue, but it is not good for the country that there should be that embargo on the free flow of transactions, of barter and sale. It is a handicap to the industry of the country to have it that way.

Senator SIMMONS. Then you think that if we reduce it to 20 we would get still more revenue?

Secretary MELLON. There is a question of where the saturation point is, you might say. We have discussed that. I think it is below 25 per cent.

Senator CURTIS. If the chairman will remember, Mr. Simmons, we asked Dr. Adams the other day to figure that out with experts in the Treasury and let us know as soon as he could just what that would amount to.

The CHAIRMAN. Yes; that request was made and the information was to be furnished.

Senator REED. Do you think the same rule applies here that applies in the matter of a tariff, that if you make the tariff too high you will get no revenue because no goods come in?

Secretary MELLON. Exactly.

Senator REED. And if you make it too low you will get very little revenue because it is not high enough to get anything?

Secretary MELLON. Exactly; and what supports that position is the record of the department as to the higher brackets of surtax, how they have dropped down; and it is rapidly coming to a place where they are unproductive. The reason is not only the fact that transactions are prevented, but with the high brackets of surtax there are so many ways of avoiding the tax to a man who has an income. Generally what is referred to as the chief factor is the investment in tax-free securities. That is not so. The investment in tax-free securities is a large factor, but it is not the leading factor. There are many other methods.

For instance, from my knowledge of the incomes in business, etc., of individuals, I do not know among them any who to any large extent invest in tax-free securities, for the reason that they have not the free cash with which to do it. They are generally people who are in industrial lines of business, and they have to carry on their business and they need their capital. They can not get it out to invest it in tax-free securities. I do not think that is the largest item.

But if you take a man who may have an income of three or four hundred thousand dollars a year, or a larger amount, he can do so many things. He can divide up his property with his wife and his children, and that cuts his brackets down because his income is less, and he does not pay the high surtax. Or he can make trusts for his children and those to come after him and part with his property, with a trust that accumulates for them, and therefore he is relieved; he immediately drops from the higher surtax down to the lower surtax.

There are dozens of plans. It is shown and proved in the result in the department where you see that the number of higher surtax people are dropping down and the revenue is going down.

There are so many of these different ways that I know of that have not been actually availed of. For instance, I know of a man who has a large income, a very high income. He invested in a piece of real estate. It was coal property. It cost about $4,000,000. The reason he invested in that was that he considered that at some time in the future it would have greater value, and that perhaps at that time in the future there would not be the same surtax or high tax rate, and in the meantime it would be increasing in value. He was using his money in other directions, but he bought that property on a payment of a comparatively small amount down. He made a payment of $200,000 down and then a payment of $200,000 a year running each year for 10 years, and at the end of the 10 years he would pay the balance or the bulk of the purchase money. He paid 6 per cent interest on the money.

That was the effect of his large surtax. In that instance he paid somewhere about 65 per cent. The interest at 6 per cent was deductible from his income and therefore the Government paid 60 per cent of his 6 per cent interest. In other words, the Government carries the payment of that interest for the time, and he goes free to the end of the time and pays off his property, and he can sell it then and make his profit; and if there is not a large tax at that time he is that much ahead.

But the point is that in the meantime the Government has relieved him. Instead of paying 6 per cent he is paying 2½ per cent to carry that property, because the interest he pays is deductible from income and he gets that deduction which relieves him to that extent.

Senator REED. He does not work his coal field?

Secretary MELLON. No; it is just standing there.

Senator REED. Why could not that be reached by a proper clause in the law?

Secretary MELLON. That could be reached, but you can keep on putting proper clauses in and reaching something and then something else. That is just one instance. There are all kinds of ways, and the people who resort to them are within their rights in doing it. They avoid taxes by making investments. It is human nature and you can not change human nature.

The point is that that sort of an extreme tax defeats its own purpose. It is bound to. It may, in the beginning, in the first year, catch a certain amount of money, but it does not continue at all.

Then, there is another still greater injury to the country from that sort of tax. I can remember, in the community where I live, the favorite investment by men who had a large income, or by executors of an estate, was in real estate mortgages, mortgages upon real estate, and the money would be used for building, and so forth. It used to

be a 5 per cent mortgage. A 6 per cent mortgage was a good security. To-day there is no such thing in our district, scarcely, as a 6 per cent real estate mortgage. They can not get the money. They can not get the money to invest in real estate on that sort of a basis, because the people who always did invest their money in that direction were people of ample or large incomes who have these big surtaxes, and therefore if they only get 6 per cent on their investments their net is perhaps only 3 per cent, and they do not make the investment. What is the result? Capital does not flow into investments in real estate, into buildings and construction of that kind. It is diverted and obstructed from going there.

Senator REED. Where does it go?

Secretary MELLON. The chief result of that has been the high cost of rents. There has been scarcely any building in the last few years, or even now. To some extent that is on account of the high cost of materials, etc., but the great factor in the stoppage of building and in making this housing situation acute has been this law that prevented capital from flowing into investments that were always desirable and solid, the real estate investments of the people.

Senator REED. Where does that capital find a place for investment?

Secretary MELLON. In all sorts of ways. Of course, they invest in tax-free securities, or they can get all kinds of investments at 7 and 8 per cent. Then there are these other methods of avoiding the tax. One way and another the capital does not go there. The result of that is that these laws that are wrong in principle, that are extreme in the way I speak of, have been the chief cause of the cessation of building houses. The result of that is that the rents of the people have been raised, and the consequence is that the wage earner, or the man of small income who has to rent his house, instead of paying perhaps $30 a month for a house, is paying $60 a month. He is paying $60 a month because capital is not placed in the direction to keep building up.

If you take the amount that is short in the housing in the country--this country is short of houses of the moderate class—if you take the statistics, it runs into an enormous amount. Suppose the Government should go into the building of houses. In order to supply that demand, it would take more than our whole war debt to do it; and the only way that it is ever going to be done will be through the natural flow of capital in that direction, the investment of surplus and savings in that direction, in the regular way. But as long as you put an embargo on it by these high surtaxes you are going to prevent that, and you are going to raise the rents on the men of moderate means. I am convinced of that position.

In other words, you are driving that capital out into other channels where you do not even get the benefit in the Treasury from the tax.

Senator WATSON. Then you think that 25 per cent surtax is the point at which we would get the most revenue and do the least harm?

Secretary MELLON. I think this, that 25 per cent will bring more revenue than the higher rate will. The situation is not generally understood; and to recommend a lower level than that would not be fully understood. But I believe that a lower level would, in the course of a year or two years, be more productive than 25 per cent.

The CHAIRMAN. Mr. Mellon, did you recommend this lower rate to the Ways and Means Committee?

Secretary MELLON. I did.

The CHAIRMAN. I did not remember that.

Secretary MELLON. Yes, sir; that rate was recommended beginning January 1, 1922.

The CHAIRMAN. They made a higher rate?

Secretary MELLON. They made it the higher rate.

The CHAIRMAN. When would you advise having this reduction go into effect?

Secretary MELLON. The first reduction was recommended to go into effect the 1st of January, 1921; but 1921 is nearly over, and I would think, under the circumstances that beginning with January 1, 1922, would be the proper date.

Senator SIMMONS. Nineteen hundred and twenty-one is nearly over, but these income taxes are based upon the income of the year, are they not?

Secretary MELLON. Yes; and I think it would be better to eliminate that tax for the year 1921. But of course that will make quite a difference in the income. The year has gone along and people have had to contemplate paying the taxes, etc.; so that the situation is rather different. It would be much better, for instance, to have the tax placed in some other direction if it were feasible to do so, because the money that would be released in that way would be available for productive investment. But I think that, considering the revenue question, and that the matter has run on to this extent, it would scarcely be practicable to eliminate it for the year.

Senator SIMMONS. My recollection is that it was estimated that the reduction of the surtaxes from 65 to 32 per cent would reduce the revenues.

Senator LA FOLLETTE. Ninety millions.

Senator SIMMONS. And that discussion took place in the House upon that basis. You take exactly the reverse position. They were wrong in that, were they? I would like to know who made the estimates. Did you make them, Mr. McCoy?

Mr. McCOY. Yes, sir.

Senator SIMMONS. Will you give us your views about that?

Mr. McCOY. That was the estimate for the first year. As the Secretary says, it will take a little while for people to grow familiar with it. There is no doubt that the higher surtaxes are destructive to initiative. Very many people would go into business ventures, if the surtax were less, than would go in now.

Senator SIMMONS. We might agree to that; but do you estimate that reducing it from 65 to 32 per cent would result in a loss of $90,000,000 of revenue?

Mr. McCOY. For the first year; yes, sir.

Secretary MELLON. That is the reason that I make it the year 1921. As it goes on the situation changes. Suppose that you keep the tax exactly as it is. The amount being collected is rapidly being reduced, and you would get more the first year than you would the next year, because, at the rate it has been falling off, it has been dropping more than half each year.

There is a table here which shows the amount that it has been falling off.

Dr. ADAMS. You have those figures in the little pamphlet before you, gentlemen, at page 5.

Secretary MELLON. For instance, take the incomes over $300,000, that is, when you get into the brackets where a man has an income of $300,000, or about that much.

In the year 1916 there were $706,000,000. In 1917, $616,000,000; 1918, $344,000,000; 1919, $314,000,000.

It has been dropping down. All of those drops came before the depression in business. Now you have got a situation where the depression in business, in addition to other things, has been taking away the income. The man who formerly had $300,000 a year, with the depression in business perhaps has not more than half that amount now.

Senator REED. Likewise his surtax goes down immediately.

Secretary MELLON. Likewise his surtax goes down.

Senator REED. Therefore he gets, automatically, relief from the burden and is ready to go on and sell his property.

Secretary MELLON. Yes. I think Mr. McCoy's estimate for the first year, of $90,000,000, is above the mark considerably.

Senator SIMMONS. But you are arguing that it will actually increase; that reducing it to 32 per cent would actually increase instead of reduce the revenue.

Secretary MELLON. The benefit from the reduction of the surtax would not commence to accrue immediately, you see. You have to wait until the income comes in and until the transactions occur.

Senator MCCUMBER. Right there, Mr. Secretary: As all the business up to the present time has been conducted upon the assumption, probably, that it will have to conform to the present surtaxes, and as the new tariff bill or this revenue law probably will not become effective until the very last of the year and all the disadvantages that accrue from the high surtaxes will have accrued already, then would not that be an argument for making it take effect January 1, 1922?

The CHAIRMAN. That is what he said.

Secretary MELLON. That is just what I said, Senator. Say that at the end of last year we had been considering it. Then I would have said it would have been a benefit to reduce it at this time. But the benefit comes in the future, you see, from the time the reduction is made.

Senator SIMMONS. Is it your proposition not to decrease surtaxes until 1922 at all?

Secretary MELLON. To allow it to stand, but, commencing with January 1, 1922, the top bracket, the highest of all, be made 25 per cent.

Dr. ADAMS. It gives you a total tax of 33 per cent.

Secretary MELLON. Of course the normal tax is to be added to that. If you make it 25 per cent, it makes the total tax 33, while under the House bill, with the total tax of 33, it becomes 40 per cent.

Senator MCCUMBER. Mr. Chairman, it seems to me that it is quite certain that we can not get through with the Secretary for several hours. Would it not be well to take our recess for lunch now and meet again at half past two, or whatever time you think best?

The CHAIRMAN. Will you be here this afternoon, Mr. Mellon, or would you rather return to-morrow?

Secretary MELLON. I can come this afternoon.
The CHAIRMAN. I would suggest that we meet at 3 o'clock this afternoon.
Senator REED. Would it be possible for you to get that information that we have been calling for?
Secretary MELLON. You mean, from the heads of the departments?
Senator REED. Yes.
Secretary MELLON. It will take a little time to do that.
Senator REED. I suppose it is made up.
Secretary MELLON. I suppose it is, but it takes a little time to get it, anyhow.
The CHAIRMAN. The committee will take a recess until 3 o'clock this afternoon.
(Whereupon, at 1.15 o'clock p. m., the committee took a recess until 3 o'clock p. m.)

AFTER RECESS.

STATEMENT OF HON. A. W. MELLON, SECRETARY OF THE TREASURY—Resumed.

Senator SMOOT. If the committee will come to order, we will ask the Secretary o the Treasury to proceed with his statement. I will say that the chairman has been detained for a few moments and desires that the committee proceed and he will come as quick as he can; so if you will proceed now, Mr. Secretary, to make your statement, we will be very glad to hear you.
Secretary MELLON. Perhaps I had better go over the program again—that is, the changes that have to be made on account of the elimination of the excess-profits tax
To repeal the excess-profits tax as of January 1, 1921, and increase the corporation tax from 12½ per cent to 15 per cent; decrease the present transportation tax to 50 per cent, commencing January 1, 1922, and then to eliminate it entirely on January 1, 1923.
Senator SMOOT. Would you tell the amount, for the record, in each case, or will you have a statement at the end covering the whole of it?
Secretary MELLON. Well, I can give it to you——
Senator SMOOT. The items, and then put in the statement?
Secretary MELLON. Yes, sir. Would you like to have the items now?
Senator SMOOT. Yes; just go right along.
Secretary MELLON. Well, now, for the calendar year of 1922 the transportation tax would add $131,000,000 to the House bill. The insurance tax would add $10,000,000.
Senator SMOOT. Instead of $20,000,000, as you said this morning?
Secretary MELLON. That is for the calendar year. It only includes half the year. Proprietary medicines, perfumery, etc., $6,000,000 for the calendar year. The corporation income tax would add $275,000,000 to the calendar year.
Senator SMOOT. Not a 2½ per cent increase over the House bill?
Dr. ADAMS. Five per cent.
Secretary MELLON. You see, the present tax is 10 per cent, so that would make an increase of 2.15 per cent instead of 12½ per cent, which would be 5 per cent.
Senator SMOOT. That is what?
Secretary MELLON. $275,000,000. That makes a total of $422,000,000 for the calendar year. Do you want the fiscal year on these items? That is the calendar year.
Senator SMOOT. I would like to have the fiscal year if we can, because all the appropriations are on the basis of the fiscal year.
Dr. ADAMS. Now, you cut that in half for the first fiscal year, and it gets pretty intricate. Mr. McCoy, would it be correct to cut your excess-profits tax in half?
Mr. McCOY. No; not quite.
Senator SMOOT. Because March 15 is the first payment, and June 15 is the second.
Dr. ADAMS. But it would be approximately so.
Mr. McCOY. It is arranged here, the total receipts.
Senator SMOOT. In the first quarter they get all the payments that are made in full.
Mr. McCOY. They get between 55 and 60 per cent of the total in the first two payments.
Secretary MELLON. Now, do you want what is lost from the House bill as it is before you?
Senator SMOOT. That is for the repeal of the excess-profits tax?
Secretary MELLON. Yes, sir.
Senator SMOOT. Yes.
Mr. McCOY. The excess-profits tax for the calendar year is $450,000,000.
Secretary MELLON. The excess-profits tax for the calendar year is $450,000,000 and the cancellation of the capital stock tax does not change the fiscal year at all.

Mr. McCoy. The abolition of the capital stock tax is intended to begin July 1, 1922, so that it does not affect the fiscal year of 1922. It begins at the expiration of the year.

Senator Simmons. That is part of your plan?

Mr. McCoy. Part of the Secretary's plan, yes.

Senator Reed. I would like very much to have it for the fiscal year.

Dr. Adams. All of your printed tables have them on both bases.

Senator Simmons. Why couldn't Mr. McCoy take the Secretary's suggestion and have before us here to-morrow morning exactly the amount of income that would be lost by reason of these changes and exactly the amount of income that would be increased?

Secretary Mellon. That is what I was giving you now.

Senator Simmons. He ought to have it typewritten so that each one of us could have a copy of it.

Mr. McCoy. They are just finishing it, Senator. We have been working at it ever since you left.

Senator La Follette. Couldn't it be typewritten in a few minutes? It isn't a long table. Just give it to a stenographer and let him typewrite it and then we could have it in five minutes.

Secretary Mellon. Yes; that would be better.

Senator Smoot. Now, if there is anything further that you desire to present to the committee outside of the retroaction of the excess-profits tax to January 1, 1921, you may proceed until that statement is returned to the committee.

Secretary Mellon. Well, it did not seem to me that there was any change to suggest other than these that we have now offered. That would allow of revenue sufficient to cover the estimates of expenditures, and it would do away with the excess-profits tax; do away with the capital-stock tax; it would increase the flat tax or income tax on corporations, and it would retain one-half of the transportation tax for the coming year and add one or two minor taxes.

Senator Smoot. Mr. Secretary, are you really in favor of increasing the tax of 12½ per cent on the net profits of corporations?

Secretary Mellon. Well, you are wiping out the excess-profits tax and the capital-stock tax.

Senator Smoot. Yes; I recognize that, but then there are so many, many of the corporations that have no excess-profits tax.

Secretary Mellon. That is true.

Senator Smoot. It does not relieve them at all, but it imposes here quite a burden.

Secretary Mellon. Well, but it is this, that it is a plain tax and they are paying it now. They are paying 10 per cent now, and it is a tax on the net profits, so that it is not in that way a burdensome tax. It is so much better than a tax that is intricate and bears unevenly, like an excess-profits tax.

Senator Smoot. I agree with you there, Mr. Secretary, but I thought perhaps there would be a better way to raise $125,000,000 than to put this 2½ per cent additional tax on there.

Secretary Mellon. Well, we could do that by adding some other things. We could increase the postage 1 cent on first-class postage, which would make $75,000,000. You could increase the documentary stamp tax. They produce now about $55,000,000 and they could be doubled. That would add another $55,000,000 there. You could get seventy or eighty million from the documentary stamp tax. I think those would be better; but there is a very general objection to adding new items of taxation. It does not seem to be the practical thing to do. There is a great deal to be said in favor of a tax that the subjects are accustomed to. They are accustomed to this flat tax on corporations. It is simple. They all make statements of net profits, and this is simply a percentage on net profits. They are paying 10 per cent now. They will be paying 15 per cent; at the same time even those companies that have no excess-profits tax are relieved from the capital-stock tax, because the capital-stock tax applies to all corporations. Whether they earn any money or not they are all subject to the capital-stock tax.

It seems to me that this program would be an equitable one, and it is one that the taxpayer is accustomed to. It isn't something new; it is not departing from what he has been accustomed to. And to a great many corporations, an excess-profits tax, even if it is not burdensome in the amount of money to be paid, is a very difficult tax.

Senator Smoot. It brings so many complications into the department in the way of collecting the taxes and the final settling that it ought to be repealed if it can be, in my opinion.

Senator Simmons. To what extent do you think the repeal of the excess-profits tax is going to stop profiteering? Profiteering is the greatest evil of this country to-day.

Secretary MELLON. Well, you can not tell, as far as profiteering is concerned, what effect one tax over another could have.

(Informal discussion, which, at the direction of the chairman, was not recorded.)

Senator SMOOT. Now, is there any other member of the committee who desires to ask any further questions of the Secretary at this time?

Senator WATSON. I have been trying to get an answer to my question.

Secretary MELLON. Senator Watson, that is being printed now—the exact figures. I was giving them out here, and then it was thought better to have them printed and drawn off.

Senator CURTIS. Has the Secretary completed his statement?

Senator SMOOT. Until that statement comes, and I asked whether there was any member of the committee who desired to ask the Secretary any questions. I had intended to go further into the question of the expenditures and revenues of the Government and ask the Secretary certain questions, to see if we agreed upon certain points, but evidently that is not interesting to the committee, so I will not proceed further.

Senator LA FOLLETTE. I think it is.

(An informal discussion which, at the direction of the chairman, was not recorded.)

Senator WATSON. Mr. Secretary, what do you think of a manufacturer's tax?

Secretary MELLON. Manufacturing establishments are very badly off at this time. It would be pretty hard to put a production tax there. You can say that they pass it on, but there is very limited trade and they are seeking the trade, and you certainly do not encourage that trade by adding to the cost, and you can not put a tax on without adding to the cost.

Senator SMOOT. That is the same with any tax?

Senator DILLINGHAM. Doesn't any tax add to the cost?

Secretary MELLON. Any tax adds to the cost, but people are accustomed to taxes that are being paid on certain methods of levying the tax. They are accustomed to that. Now, to make a departure at a time of depression, and especially to the sources of production, where the manufacturers would be subject to this tax, it seems to me would be a bad method. It seems to me that it would just add to the unfavorable conditions.

Senator SMOOT. My impression is that the American people want a change in tax. Not only that, they are going to have it sooner or later.

Secretary MELLON. Of course, you can not add a tax on manufactured products without adding the tax to the consumer. It goes to the consumer. For instance, all food that is manufactured, you add that tax to all food. Clothing is all manufactured. All items of necessities of life are manufactured and that tax is added.

Senator SMOOT. They are all sold at retail, too.

Secretary MELLON. That is all very true, but you are specifically adding a tax at the source of production. Now, that is not a good place to put the burden.

Senator SMOOT. You want to put it on the consumer?

Secretary MELLON. Well, you had better put it equitably on the consumer than to put it there, because then it goes on at the time when the article goes into consumption and it is more direct.

Senator WATSON. Of course, the sales tax goes directly to the consumer, and it is paid by him and manifestly that is the very object of it.

Senator DILLINGHAM. But every manufacturer who has been before us has said that he passes his tax on to the consumer; every one of them invariably has said that.

Senator REED. And add a profit to it?

Secretary MELLON. It could not be otherwise. It must go that way.

Senator SMOOT. So I do not think there would be 1 per cent of the manufacturers of the United States that would object to it.

Secretary MELLON. I think this, that the ideal system of taxation, if it could be inaugurated, if you could do away with all of the other taxes and make an equitable tax on all turnovers—all sales of real estate, goods, wares, and merchandise, everything, it would spread the burden of taxation as much as it can be spread, with the exception of some taxes like excise taxes on tobacco and places peculiarly adapted for taxation, and then you would have the ideal system; but, it would be a mistake to piece up the system of taxation to bring in new methods of imposing taxes at a time like this.

Senator SMOOT. I would not have any new methods; I would take 37 of the varieties that we already have, if I had my way about it, and do away with them, and I think that the income tax ought to do that.

Secretary MELLON. Well, people are accustomed to paying them that way.

Senator SMOOT. Of course, I think the income tax is absolutely essential, no matter what tax you have, because that is where taxes are equalized.

Senator REED. Mr. Secretary, have any men in your department made an estimate of the amount of revenue that might be collected from the sale of 2½ per cent

beer? I am asking it more out of curiosity. I have heard the statement made that there was an estimate there, and I would like to know if it is a fact.

Secretary MELLON. No, I do not think so. I have heard statements that gave a very large return, but I have not had any statement in the department. I do not know whether such a statement could be arrived at. There is no doubt but that a very considerable revenue could be derived. I have heard it estimated that a half billion dollars could be obtained in that direction. I do not know.

Senator WATSON. Did you give us your opinion about the manufacturer's tax Dr. Adams?

Dr. ADAMS. The manufacturer's tax?

Senator WATSON. Yes.

Dr. ADAMS. My opinion is as the Secretary's, that at the present time the prosperous and successful lines of business enterprises are, relatively speaking, bankers in the first instance, who, I should say, are making more money than any other class: the retail distributors more prosperous than the other lines; and the least prosperous are the farmers and the manufacturers. Now, then, it seems to me a very unfortunate moment to pick out those for special taxation, and I think you gentlemen have got to admit this—I do not want to go into a discussion of whether taxes are passed on or not—but whatever is said, the imposition of the tax must do some harm. I do not think a business concern can make a profit out of a tax or else they would welcome taxation. Some harm it does do them. What harm it is I do not need to describe. Obviously they do not want it, and obviously it is unpleasant. Therefore I do not think that if the taxation is unpleasant, if it hurts, and if it injures in some way, I do not think it is the proper time to pick out the class that is the least prosperous to pay 3 per cent additional tax. I think you have to qualify, in your mind, the theory that taxes are passed on and that the producer charges a profit on it. That is, if true, it is true in some way in which, nevertheless, the taxpayer is distinctly injured. Now, I call your attention to this: It is admitted in any discussion on the subject—the tax is believed to be passed on, this kind of a tax, because it is essentially cost of production. It is an expense of the business, and that the manufacturer must pass it along because it is an expense of the business. Now, with respect to every other expense of business, it is recognized as natural that the business should protest against it. It is recognized as natural that it should not welcome an increase in wage cost or rentals. It does some harm in some way. Now, then, I can not consider that the tax is simply passed along without doing some harm to the taxpayer who pays it. It does not seem to me the proper time to select the element of the community that is the least prosperous for an additional tax.

Senator REED. What do you refer to when you say "an element that is the least prosperous"?

Dr. ADAMS. The manufacturing community is less prosperous than either the banking community or the distributing community or dealers. Now, we propose to exempt those two great elements of society and put this new tax on the manufacturer, and the explanation of that is that the manufacturer passes it along; but I say, with respect to that, whether that be true or not, the tax must do some grave injury to the taxpayers or they would not protest so vigorously against its imposition. In my opinion taxes not fully passed on in a time of depression; but I do not want to argue that at this time. That is a big question, but I do say that taxes must do some harm.

Secretary MELLON. It would be the same as any other item of expense, like increase of salaries. It is part of the overhead expense and general expense of the business organization. It is just that much additional cost of expense, of that overhead, and has to be estimated and eventually is passed on. I say it must be.

Senator SMOOT. Nobody denies it. I say it is, and that every tax is the same way.

Senator REED. What the doctor has suggested might find some explanation in this: For instance, a manufacturer of shoes, finding that the heavy tax is put upon shoes, knows that inevitably two things will result: He has to invest more money, and, secondly, it circumscribes his sales to some extent. If he is dealing in a thing that there is any conceivable substitute for, the substitute is liable to come in and take a part of his trade.

Dr. ADAMS. Those are partly the results.

Senator SMOOT. If it was a substitute, it would pay the same thing.

Senator WALSH. You made a casual reference to increase in documentary taxes and possible increase in postal taxes. Did you want to say any more on that subject? Earlier in the day you said those were possible sources of revenue.

Secretary MELLON. The question was asked me with regard to an increase of the corporation's flat tax or income tax, what could be done to avoid adding that tax to the corporation, and I said that some other subjects of taxation, such as an increase in the first class postage rates or an increase in the documentary stamp tax, would be

the most equitable or most available for that purpose. The increase of 1 per cent in the postage rate amounts to about $75,000,000, and the documentary stamp tax could be increased easily to sufficient to yield from $50,000,000 to $75,000,000. In those two items you could get approximately $150,000,000.

Senator WALSH. What would be the increase in the documentary stamp tax.

Secretary MELLON. The present documentary stamp tax I believe in the past year was $55,000,000.

Mr. McCOY. It is $9,000,000 on the transfer of capital stock; $8,000,000 on the sale of produce and exchange.

Secretary MELLON. Now, those are just incidental to transactions—transfers, etc. They are not burdensome.

Senator WALSH. To raise that to $75,000,000, how much would you increase the rate? Fifty per cent?

Dr. ADAMS. You would have to increase it 100 per cent so do that. For instance, the tax on capital stock sales is one-fiftieth of 1 per cent.

Secretary MELLON. It is not large and it is not burdensome at all. But, with the addition of 2½ per cent of this corporation tax, it would be unnecessary to add a new item of that sort. There was very great objection when this matter was up in the House to new items, such as the postal increase and others. They seemed to object to it very much.

Senator SMOOT. Well, I should think they would.

Senator CALDER. Under section 600 of the bill we find that there is a provision permitting the levying of a tax of $4.20 upon spirituous liquors when used for beverage purposes. It is in the bill as passed by the House. Why wouldn't it be a good idea to place a flat tax of $6.40 on all spirituous liquor, whether used for medicinal purposes or not?

Secretary MELLON. What would be there, then?

Senator CALDER. The tax on medicinal liquor to-day is $2.20. Liquor for beverage purposes the bill recites should be $4.20 additional. Well, then, let us tax $6.40 on every bit of liquor, whether for medicinal purposes or what not.

Secretary MELLON. Well, that could be done, but where do you have a place to put a tax on beverage liquor?

Senator CALDER. Well, I want to know that, but the bill as passed by the House provides for it.

Secretary MELLON. That is on illicit sales?

Senator McCUMBER. There are many other ways by which you could secure very good revenue if you want to allow the breaking of laws.

Senator CALDER. But to-day much liquor that is taken out is used for beverage purposes. If you go to a drug store to-day you pay $4 for a pint of whisky.

Senator McCUMBER. No one is going to admit that he is using it for beverage purposes.

Senator CALDER. Well, let us eliminate that part of it and put a straight tax of $6.40 on all liquor.

Senator McCUMBER. Well, that would make the law as though it was intended to legalize illicit sales.

Dr. ADAMS. The history of that is this, sir: There are a great many people who are hailed up for breaking the law and at the present time it may be proved in effect that they have sold liquor for beverage purposes. Under the circumstances the question that arises is, is that subject to the beverage tax of $6.20? That has never been repealed—$4.20 additional. We are in doubt about it.

Senator McCUMBER. The Constitution prohibits the sale of intoxicating liquor for beverage purposes. Now, you are going to put a tax on it, and in that way you sort of legalize it, or in some way you invite people to break the law. I can not understand that.

Senator WATSON. We argued that the other day.

Dr. ADAMS. Then the department would appreciate it if you would say to us, "Do not collect $6.40 when you find liquor has been sold for beverage purposes." The situation is that you have now a tax of $6.40 on alcoholic liquors sold for beverage purposes.

Senator McCUMBER. If you are going to meet that, why, meet it by a fine on the person who commits the offense and let the money go into the Treasury. At least, you are not playing with crime then.

Senator CALDER. Let us just say that all liquor sold for medicinal purposes shall be taxed at $6.40. You would get $50,000,000 more revenue, whether it is sold for any purposes.

Senator WATSON. That places it on the broad ground that practically all liquor withdrawn for medicinal purposes is really used for beverage purposes.

Senator SMOOT. The bill as passed by the House provides that on all distilled spirits on which a tax is paid at the nonbeverage rate of $2.20 per gallon, which are diverted to beverage purposes or for use in the manufacture of products or any article used or intended to be used as a beverage, there shall be levied and collected an additional tax of $4.20 on each proof-gallon and an additional tax of a like rate on all fractional parts of such gallon, to be paid by the person responsible for such diversion.

Senator MCCUMBER. I would rather say that it should be a fine of a thousand dollars.

Senator CALDER. I would cut that all out and make it $6.40 on every gallon, and that would put $50,000,000 into your Treasury.

Senator MCCUMBER. Nobody is going to admit that he sold it for beverage purposes.

Senator SIMMONS. Before the war it was illegal for anybody to manufacture whisky except at a registered distillery; yet if he did manufacture liquor at an illicit distillery, he was required to pay the same tax upon what he manufactured as if he manufactured at a Government distillery.

Senator MCLEAN. But there was no law against the sale of it. You could not very well put a legal tax on an outlaw article. You have to call it a penalty. You can accomplish the same purpose.

Senator SIMMONS. That tax was a manufacturer's tax.

Senator MCLEAN. Yes. And it was against the law to make it, but not against the law to sell it. Now it is against the law to sell it for beverage purposes.

Senator SIMMONS. This was a tax for making it. The man who manufactured liquor had to pay a certain tax—a manufacturer's tax. Now, if he manufactured it at a Government distillery, licensed according to law, he had to pay that tax. If he manufactured it at an illicit distillery, without any license, he had to pay that tax also.

Senator MCLEAN. I do not see how you can put a legal tax upon an illegal act. You have to call it something else. Call it a penalty and you will get along all right.

Senator SIMMONS. Yes; I see the point.

Senator WATSON. Mr. Secretary, you have not shown in this statement the amount of revenue we will lose if we repeal the excess-profits tax and make it retroactive, and what you propose to substitute for that total loss.

Secretary MELLON. Well, we have here what we propose to substitute, but we have not put down the amount.

Senator WATSON. But you haven't enough to make up the loss stated here, have you?

Dr. ADAMS. Now, in the fiscal year you have plenty because you lose only one-half.

Senator CURTIS. I think before you came in, Senator Watson, Secretary Mellon made some statement that he would not recommend the repeal of the excess-profits tax for this year, because so much of the year had gone.

Senator WATSON. I did not so understand it. He said that he did not recommend the repeal of the surtax.

Secretary MELLON. Exactly.

Senator SMOOT. I thought this statement would include the substitute tax and the amount to be collected from that to take the place if we eliminate the excess-profits tax.

Senator WATSON. That is not in it.

Senator SMOOT. Now, you were out, Senator, when the Secretary made that statement. This is in round numbers—if I am wrong I want the Secretary to correct me—that is simply to reduce the transportation taxes one-half, and that would raise $131,000,000. That is to take effect January 1, 1922. From the tax on extracts, proprietary medicines, etc., we will raise $6,000,000. We will raise from insurance; that is, by a reduction of only one-half, $10,000,000. Raise the flat tax on net gains of corporations from 12½ per cent to 15 per cent, and thereby raise $275,000,000.

Dr. ADAMS. That is, from 10 to 15.

Senator SMOOT. From 10 to 15, but I am speaking of the House bill.

Dr. ADAMS. But the House bill does not go into effect until January 1, 1922, so that your increase is 5 per cent there.

Senator SMOOT. Yes; that is true; $275,000,000.

Dr. ADAMS. That is for the entire year. That ought to be a little more than one-half.

Senator WATSON. That is the reason I do not think you have enough here. We lose approximately $400,000,000 if we repeal the excess-profits tax.

Senator SMOOT. That is right. It is only the half year.

Dr. ADAMS. If you put the tax on for 1921, you will collect the first two payments in the first half of 1922. In other words, you will have one-half of it in the fiscal year of 1922.

Senator SMOOT. That would be only $285,000,000.

Senator WATSON. That is why I say you haven't enough. I thought there was a part of that that you intended to recommend.

Dr. ADAMS. You lose one-half of your excess-profits tax.

Senator SMOOT. Of course that is true for this year, but we want to pass a law here——

Dr. ADAMS. Then you must double up your transportation tax, and so on. You must put $262,000,000 transportation, $20,000,000 for insurance, etc., because this is only for six months' collections here.

Senator SMOOT. That is what I say. You are only taking care of the present fiscal year with these suggestions here. Then the next fiscal year we will be in the same boat again and fall short.

Secretary MELLON. If you will take the fiscal year and make these changes, you will find enough to cover it.

Dr. ADAMS. Now, if we put the corporation income tax at $140,000,000, that would be $287,000,000 for the half year. The corresponding figure would be one-half, approximately, the excess-profits tax of $450,000,000—say, $225,000,000 or $230,000,000. Now, if you double that all up, the situation would go against $450,000,000 excess-profits tax, substantially doubling those figures. Now, that $131,000,000 transportation business for the whole year is $262,000,000. Insurance, instead of being $10,000,000, is $20,000,000. Corporation income tax for the whole year is $267,000,000 instead of $140,000,000. I think it is substantially covered here and more than covered.

Senator SMOOT. We have got now two more collections on the excess profits tax during this year from the business of 1920, haven't we?

Dr. ADAMS. Yes. That would not be repealed.

Senator SMOOT. Not the 1920 taxes, because they go up to January 1, 1922.

Senator MCCUMBER. No; not for this year.

Secretary MELLON. What we are collecting now is 1920. You do not repeal that.

Senator SMOOT. No; but what I am talking about is that when that is repealed you have to make arrangements for the full year for whatever loss there is for the full year and not the half year.

Secretary MELLON. But it worked out that way.

Dr. ADAMS. You double up both of them?

Senator SMOOT. If you double it up, it is all right.

Senator WATSON. I suppose you are going on the theory that next year we will not have to pay three or four hundred million dollars to the railroads.

Dr. ADAMS. Certainly.

Senator SIMMONS. Why couldn't you work this problem here and show us exactly how much you would get?

Dr. ADAMS. That is precisely what has been worked out.

Senator SIMMONS. Not on this paper, it isn't worked out.

Now that is a matter of argument. Why can't we have a table made to show just exactly what would be the collections under the proposed changes made by the Secretary?

Dr. ADAMS. Well, we will do that.

Senator SIMMONS. Both for the full year and the half year.

Dr. ADAMS. You mean the fiscal year or the calendar year, or both?

Senator SIMMONS. Both, yes.

Senator CURTIS. And the losses.

Senator SIMMONS. Yes, sir.

Senator CURTIS. Give us most of it to-morrow morning if you can.

Dr. ADAMS. You have in that printed statement a very full statement. The only correction for that is this one change. We will print this that is being discussed to-day and have it before you to-morrow. It is substantially as Senator Smoot has given it to you.

Senator WATSON. Do I understand, then, that you do or do not recommend the additional penny postage stamp act?

Dr. ADAMS. The Secretary did not recommend it.

Secretary MELLON. No; not provided you increase the corporation income tax to 15 per cent.

Senator SIMMONS. Mr. Secretary, you want us to provide you money to pay what total sum?

Secretary MELLON. $4,034,000,000.

Senator CALDER. For this fiscal year?

Secretary MELLON. For this fiscal year; the fiscal year of 1922.

Senator SIMMONS. That is revenue tax?

Secretary MELLON. Not altogether. It will be revenue tax and miscellaneous tax.

Senator SIMMONS. How much do you want that is in this bill?

Secretary MELLON. In the internal revenue alone, for the calendar year, it is approximately around $2,800,000,000; somewhere around there. Here it is: In the calendar year, $2,770,000,000. Now, the fiscal year it is $3,300,000,000.

Senator McLEAN. Mr. Secretary, you have given us very good reasons why we ought not to assess a production tax of 3 per cent, yet this increase from 12½ per cent to 15 cent on corporations will, of course, hit a great many producing institutions.

Secretary MELLON. Yes; but it will only hit those having net profits.

Senator McLEAN. I know.

Secretary MELLON. You see, it is only a small percentage on their net profits.

Senator McLEAN. I know, but you have to assume that the net profits are pretty small and that they would like to keep them.

Secretary MELLON. Then the tax must be small, if the net profits are small.

Senator McLEAN. Well, if there is any other way to get this $150,000,000, I wish we could do it.

Secretary MELLON. Well, the other way, or another way, is the way suggested—the increase of the postage and documentary stamp tax.

Senator McLEAN. In that instance the goose would squawk more than if we pulled the feathers out of the corporation.

Secretary MELLON. Yes, probably.

Senator SIMMONS. Let me ask you this question, Mr. Secretary. If we adopt the suggestions made and raise this tax as shown by this statement here, how much would that raise for the fiscal year 1923?

Dr. ADAMS. It is printed in the statement there.

Senator SIMMONS. That is, when you reach a permanent basis on this retroactive feature.

Secretary MELLON. For the calendar year 1923 it is $2,000,000 plus.

Senator SIMMONS. Wouldn't it be better to have the fiscal year?

Dr. ADAMS. We find that a very difficult matter to deal with. Sometimes it is the fiscal year and then again the calendar year, that is most significant.

Senator SIMMONS. By this calendar year this bill, as changed, would yield, according to the statement, $2,270,000,000. How much would the same bill yield for the calendar year 1923?

Secretary MELLON. For the calendar year, $2,645,000,000. Mr. McCoy estimates for the fiscal year 1923 $2,735,000,000. Of course, those estimates advanced in that way are subject to change.

Senator SIMMONS. So that we would get from the revenue about $2,750,000,000 for the calendar year. I hope very much that in 1923 we may be able to get along with that amount of money, supplemented by miscellaneous and profits taxes.

Secretary MELLON. I was going to make the suggestion that for the fiscal year you have a prospect of increasing this. There will be a greater amount of business, so that the chances are the revenue will be greater. If we have an improvement in business—and it is very probable that we shall—then you will have an increase in revenue, so I think the estimates are very safe for the 1923 period.

Senator SIMMONS. You do not think it is possible there will be a falling off?

Secretary MELLON. I do not think it would be possible to get much worse than it is.

Senator SIMMONS. I hope not.

Senator CURTIS. Is that all?

Senator SIMMONS. Is there anything further you wish to present, Mr. Secretary?

Secretary MELLON. I do not know of anything further. I was speaking to Mr. McCoy in connection with this statement. I was wondering whether we could have it ready by to-morrow morning.

Senator SMOOT. We intend to have that fixed up.

Senator SIMMONS. The committee will stand adjourned until to-morrow morning at 10.30 o'clock a. m.

(Thereupon, at 4.10 o'clock p. m., the committee adjourned until to-morrow, Friday, September 9, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

FRIDAY, SEPTEMBER 9, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Reed, Walsh, and Gerry.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives; Mr. J. S. McCoy, actuary, Treasury Department; and Mr. A. W. Mellon, Secretary of the Treasury.

The CHAIRMAN. The committee will come to order.

Dr. Adams, will you please state, for my information among others, just what program you purpose to follow this morning?

Dr. ADAMS. Senator, I had thought, after some discussion yesterday, that the time had come for you gentlemen to suppress me and take up the big, substantive questions. I shall be glad to be suppressed.

I thought you were going to take up the excess-profits tax and the making of it retroactive, and, if you make the surtax reduction, as to what time it would become operative; also the question of abolishing or repealing the capital stock tax.

The CHAIRMAN. Are there any further questions that the committee desire to ask the Secretary? I have asked him to be present at 12 o'clock to-day for a few moments.

Senator WATSON. There was one question that I wanted to ask him, Mr. Chairman, and we did not get to it; that is, the matter of the increase of this appropriation from $7,000,000,000 to $7,000,500,000.

The CHAIRMAN. He is going to come down especially to explain that.

Senator WATSON. That is all I wanted to know. We did not ask him, and Dr. Adams did not care to discuss it.

The CHAIRMAN. The committee now proceeds to the consideration of the bill in executive session, in conference with Dr. Adams, and I now call on Dr. Adams to present to the committee the order and method which he would suggest for its consideration.

The committee will proceed to the consideration of number 1, the repeal of the excess-profits tax as of January 1, 1921.

STATEMENT OF DR. T. S. ADAMS—Resumed.

Dr. ADAMS. Mr. Chairman, I think with respect to this that the Secretary would recommend it not only to the gentlemen who are opposed on principle to the excess-profits tax, but also to those who, in principle, believe in the excess-profits tax. I think he feels that the tax is not doing its intended work, that it is not reaching the ends which its friends would desire. Personally, I am one of the friends of the excess-profits tax, or would be if it accomplished its purpose. I think he feels that it does not accomplish its purpose. In the little group of tables published yesterday there is a table which illustrates this and which I think is thoroughly true, showing that the earnings of moderately sized and small corporations are at a very much higher rate

than the earnings of large corporations. The consequence is that the excess-profits tax acts with particular severity on the small corporation, the moderate-sized corporation, and the conservative corporation.

The corporations which, whether correctly or incorrectly, are taken by many people or held by many people to be charging excessive prices and making excessive profits are likely to be excessively capitalized. They get off, ordinarily, with taxation which seems to me too light; that is, in comparison with what other corporations are paying. I think they will get off with unusual completeness in the present year.

For instance, there are some statistics in Table 4, given yesterday, which are based upon the returns for 1918, the tax collected in 1919. That was the year of the 80 per cent war-profits tax as well as the excess-profits tax, and those figures reflect what all my experience has led me to believe and what I think is unquestionably true, that the heavier rate of profit, and, consequently, the heavier tax, is paid by the small corporation, the moderate-sized corporation, and the conservatively capitalized corporation.

Senator McLEAN. Have any statistics been gathered indicating what very large coroporations would be relieved entirely and what smaller corporations will be assessed?

Dr. ADAMS. We have never published such figures. That is something that the Treasury Department rather shrinks from.

Senator McLEAN. I was not asking for names, but whether you based your opinion upon investigation.

Dr. ADAMS. Senator, I could tell you many large corporations that are getting off.

Senator SIMMONS. I thought we were to have some information of that sort.

Dr. ADAMS. There is a table given here [indicating].

Senator SIMMONS. I was under the impression that in some way or other it had been indicated that the Treasury Department was having prepared data for the purpose of showing that these taxes fall more heavily upon the small corporation than upon the large corporation.

Dr. ADAMS. Here is a table that bears on that very directly. It is based upon the latest figures available in the detail required to make the necessary comparisons—i. e., the returns for 1918. It covers all the corporations which made returns of invested capital for 1918. The invested capital is over $56,000,000,000. They have been arranged in groups, as shown in the first column, with the per cent of earnings on the basis of their invested capital.

The nub of this table is in the fourth column, the column of average invested capital.

Senator McCUMBER. What does invested capital mean?

Dr. ADAMS. The statutory definition of invested capital. It includes the amount paid in for stock or shares plus the surplus and undivided profits up to the present time; i. e., the original investment, subsequent earnings, and undivided profits.

Senator McCUMBER. So it substantially means actual investment?

Dr. ADAMS. It means, in the rough, actual investment, with some modifications which rather tend to make it conservative.

Senator SIMMONS. It applies to all kinds of corporations?

Dr. ADAMS. Yes. It is shown that of the group of corporations earning less than 5 per cent the average invested capital is $1,319,000. That represents the size of the corporations in this group or class.

In the group earning from 5 to 10 per cent the average invested capital is $728,000. In general, as the rate of earning goes up, the average size of the corporation goes down. There is one exception to that, explained probably by the inclusion in that one group of an exceptionally big corporation, possibly the Steel Corporation.

So far as my experience goes—and at one time I had a very detailed experience in this field—the smaller corporations earn the higher rates of profit. The effect of it is—and I say this as a friend of the theory of excess-profits taxation—that the excess-profits tax does bear unquestionably more severely and heavily upon moderate sized, small, and conservatively conducted and capitalized corporations than it bears upon the stock-watered corporation, the large corporation; and, in general, I should say I think it is fair to generalize the corporations that you would not wish to exempt.

Senator WALSH. Is it not true, also, that it bears most heavily upon the rich or prosperous corporations than on the poor corporations; I mean those that make big profits?

Dr. ADAMS. You say rich and prosperous corporations——

Senator WALSH. We class one corporation as a rich corporation or a wealthy corporation. Does not the excess-profits tax bear more heavily upon that corporation than upon what we call the poor corporation or the struggling corporation?

Dr. ADAMS. I do not think so. If it did so thoroughly I should come here and ask you to keep the excess-profits tax.

Senator WALSH. It was intended to do so.

Dr. ADAMS. It was intended to do so; and that is the sole point that I am trying to make, that it is not accomplishing its aim.

Senator LAFOLLETTE. Where is the defect in its construction, and is it not possible to cure it?

Dr. ADAMS. Let us look at that, Senator. If it were, I would come here with proposals to cure rather than to change, so far as I had personal proposals to make.

This is the situation: Almost every prosperous corporation that is earning handsome returns on its investment acquires a valuable good will. Good will to the prosperous corporation is inseparable from it. The conservatively conducted corporation, going through reorganization after reorganization, getting its stock in the market, gathers up all of that good will and openly capitalizes it and so gets a liberal capitalization. You can not always call it stock watering. If we could detect actual watering we could cut it down under the present statute. It is a slightly different thing. They are utilizing every possible bit of good will they can get and putting it into their capitalization. The consequence is that the corporations are considering every ounce of assets at the highest value to be placed upon them, which we can not tear down or impugn or change.

If I may be permitted to cite an illustration which I think is roughly accurate, take the A company. That, as you know, was dissolved, after having gone through some such history as that which I have described. It had at that time a very large amount of intangibles, if my memory is correct, $60,000,000 worth, mostly brands.

After dissolution, the values of stock having been fixed by the courts, those figures were confirmed by the subsequent history of the market, because the stock afterwards sold above rather than below the valuations on which the dissolution process was based.

The A company paid an excess-profits tax for the year 1917 of only about 5 per cent of the net income. I use that measure of a percentage of income because we have to have some basis of comparison.

Now, take the principal competitors of the company, the B, C, and D companies. The B company paid an excess-profits tax of about 12 per cent. The C company paid about 16 per cent, and the D company about 25 per cent. In different degrees they had gotten their brands and other intangibles into their invested capital. The D company was a striking illustration. It owned one brand or trade-mark which could probably be sold for $5,000,000 or more. That was not included in their invested capital. The company had not acquired it or bought it, but had built it up. They had not reorganized and had never written up their assets.

Where intangible properties have been developed and not purchased, whether they may be included in the invested capital or not depends largely upon the accidental or incidental fact of whether the company has been through a reorganization in which the assets were written up.

Take the question of earnings. Here is a small corporation, for instance, that may have been earning on its capital 40 per cent for years. I have one such company in mind. It had been paying dividends of 40 per cent year after year. New stockholders bought in. They had paid perhaps $400 or $500 or $600 for their stock. So far as the new stockholder was concerned, he was merely getting a normal return, but the corporation would be forced to pay excess profits at the highest rate, placing it at a decided disadvantage in competition with other companies which had at some time prior to March 3, 1917, capitalized its intangible properties.

There are many reasons, some of which I have named and others of which I have not named, why the smaller corporations do regularly, as a matter of economic law, and because of differences in their attitude toward capitalization, earn higher rates of profit than larger corporations.

Senator SIMMONS. What you mean to say with reference to these brands and trade-marks and things of that sort is that if they actually bought the trade-mark or brand they would be allowed that?

Dr. ADAMS. Yes.

Senator SIMMONS. And if they developed it they would not be allowed it?

Dr. ADAMS. That is the point.

With respect to very small corporations, gentlemen, we have corrected that in the present law. Section 302 contains an interesting device which tends to ease the burden in the case of a very small corporation; but after you get up beyond the kind of corporation that is ordinarily organized with $25,000 to $40,000 capital the discrimination against them is very grave; and, frankly, I do not know how to cure it. It comes back essentially to this: That capital is not a real, fair basis for this tax. The reason back of that is that in small corporations particularly, the personality of the owner or owners—that is, the personal capital—is controlling. That is the reason small corporations, I think, earn higher rates of profit than large corporations. The officers usually own most of the stock. Their personalities are thrown into it in a way which is not true of the large corporation, and their credit is behind the corporation.

That is not true of the great, large, country-wide corporations, the stock of which is sold on the stock exchange.

That is one reason why capital, as we ordinarily know it, is not, if we look at it carefully, a sound, theoretical basis for the excess-profits tax.

The large companies as a rule pay excess-profits tax at a low rate. There are exceptions that could be named of large corporations earning large rates of profit. The E was, until its reorganization, such a company. The F until the recent enlargement of its capital, was such a company. The G, I think, was such a corporation. Where the original investors, or even their sons and daughters are receiving high rates of profit, I have no particular objection to taxing them heavily. But the stockholders who bear the tax are usually not the original investors.

There is a little company manufacturing cosmetics which has been in its way quite successful. This company had originally $25,000 capital. Their brands or trade-marks became locally quite celebrated. They got to a point where they were paying dividends of 90 per cent, and this was done for many years before the war. The stock ownership had changed hands a couple of times. The owners, when the war broke out and the excess-profits tax was applied, had no connection with the original owners. They had bought at high prices, relatively speaking. This company did not earn increased profits during the war. It did not earn very much less, but its net earnings were less during the war than they had been before. That company was called upon to pay a 60 per cent excess-profits tax, at the very highest rate, because it had never capitalized its trade-marks and good will.

In that case I think there is a real injustice.

If the original investors in the F company were still involved I should look upon the heavy taxation of that company with complacence. But if new interests had bought in, it seems to me unjust that they should pay at the highest rates while competing companies pay only half as much or less.

It is that kind of thing which leaves me disturbed. Some of it is sound and right, as I understand soundness and rightness, but some of it is altogether wrong.

Senator WALSH. Do you not think, Dr. Adams, that anybody who buys stock in a concern that has been declaring dividends of over 80 per cent is investing in more or less of a gamble?

Dr. ADAMS. No, sir; not under the circumstances of which I spoke.

Senator WALSH. Does not everybody who buys stock paying 30, 40, 60, or 90 per cent realize that he is taking a terrible chance, and that if it pays 90 per cent the next year or two years that stock may be paying only 8 or 10 per cent?

Dr. ADAMS. What do you mean by that? For instance, the average successful patent medicine company—I will not say the average, but many of them—will sell out or reorganize, and their brands will be capitalized. But some of them do not sell out or reorganize. This little company that manufactured face cream and that sort of thing could have sold its brands for a large sum, and then the company would have been earning only 6 or 8 per cent on its capital.

They did not happen to do it. The accident of the method of conducting business is determinative here when it should not be. The A company had paid for its brands. Consequently it gets them in invested capital. The E company developed its brands and does not. In both companies present stockholders may have bought stock at the same price.

Senator McCUMBER. There is another question that you have not spoken of. I am wondering what influence it would have on the question of the repeal of the excess-profits tax. It is a question of new lines of business entering into new fields, establishing new industries. Ordinarily capital will not go into a new and untried field unless there is a prospect of making a sufficient amount that will overcome the fear of a loss on the capital itself. If the Government is to step in and take a larger per cent of what you earn above what you might say was a reasonable sum upon your capital invested, the person desiring to invest will stop and think, "Am I not taking too much of a chance? If I make a big thing, the Government takes it. If I lose, I have to stand that loss myself. The Government will not share in the losses, although it will share heavily in the profits."

To what extent is that a deterrent in the matter of opening up new lines of enterprise throughout the United States which are essential to our prosperity and progress? I would like to hear you on that.

Dr. ADAMS. It is necessary to remember that the rates are not so high as they were. When we had the 65 to 80 per cent rates the deterrent effect was much greater than it is to-day.

Many people think that the possibility of the Government's taking 20 per cent above the 8 per cent deduction is a serious deterrent. I myself think it is a serious deterrent, principally in the case of the hazardous industries; and if you adopt the net-loss provision, it probably would not be so deterrent. But that is a matter of judgment. What adverse weight would you give to the possibility of the Government's taking one-fifth of your profits over 8 per cent profit and two-fifths over 20 per cent profit; what adverse weight would you give to that compared to the beneficial effect of the 8 per cent exemption? To exempt the first 8 per cent is stimulating and encouraging.

I personally believe that if we could get a sound method of excess-profits taxation that could be practically administered, if its inequalities could be ironed out, it would be the best form of business taxation that I know anything about. Such men as Otto Kahn and other authorities share that view. But the present tax in my opinion is not capable of fair, equal, and successful administration.

Senator WALSH. You recommend the repeal of this tax because of the inequalities that result from it?

Dr. ADAMS. Yes.

Senator WALSH. Do not the same inequalities result in other taxes? Take the man who puts all his capital into nontaxable securities, and another man invests in taxable securities. Why should you not repeal the tax upon that man because other men have been able to evade taxation by putting their money into nontaxable securities? There is an inequality there. There is an inequality in every system of taxation.

Dr. ADAMS. There is one point, Senator, in this connection that is frequently overlooked. The man who makes an investment in tax-free securities is really taking a lower rate of interest by reason of their exemption from taxation. They sell better. They yield a smaller return because they carry the tax exemption. The man who invests in tax frees receives a rate of from 4½ to 6 per cent as against 7 or 8 per cent in other lines.

Senator McCUMBER. He plans to buy tax-free securities because he believes he can make enough more in other lines of business to more than make things equal.

Dr. ADAMS. That does not mean that the tax-free bond is not a grave evil, but there is that compensation that I spoke of.

Senator McCUMBER. It has become so during the war. I can not see that prior to the war it was a great evil, because municipalities had to sell their bonds, and if they had them taxable they would not have got anywhere near the return upon their bonds which they did receive, and the public would have been paying a bigger interest. So I can not see that it was an evil.

Senator SIMMONS. Right there, Doctor: You say this inequality is brought about largely by the difference in capital investment resulting from these intangibles, the gathering together of them in one case and the development of the intangibles in another case. The Secretary of the Treasury yesterday, in discussing this subject of reducing the surtax, stated to us that the big incomes were paying less than the smaller incomes. He said that we ought to reduce the surtaxes down to 25 per cent because various and sundry devices had resulted, with those men who had large holdings, corporations and otherwise, by which they escaped the tax which we intended to impose upon them and which they would have to pay if they did not resort to those devices.

If that furnishes a sound basis for exemption from taxation of the kind that we impose in the one case, it does in the other. Are we to desist from imposing proper taxes because men by one device or another evade the tax or escape the tax?

Dr. ADAMS. That is a question of judgment for you gentlemen. I have done everything within my power to remedy the evils of the excess-profits tax, but I could not do it.

Senator SIMMONS. Can we levy any tax upon incomes or upon profits that is not subject to the development of these discriminations by the exercise of the ingenuity of man to escape taxes? Is not that same ingenuity operating all along the line to escape every tax that we could impose?

Dr. ADAMS. What you say is true of every tax. There is no tax that is not evaded by some. There is no tax that does not work injustice. The decisive factor is the relative importance of this injustice. Let me illustrate. The fountain-drinks tax at the present time is, to my mind, in theory, one of the soundest taxes that was ever devised. But the Treasury Department has recommended its repeal because it is so flagrantly evaded, and it would be very difficult to change it. On the other hand, the admissions tax is also evaded and has its defects, but its defects are relatively small, so that we urge its retention. The excess-profits tax, like every other tax, is unequal, but the volume of inequality and the seriousness—and that is the point, really—the seriousness of the inequity, when it arises, justify its repeal. The rates are very high, 20 and 40 per cent. When such a tax goes wrong it works grave injury. It is largely a question of rates. The capital-stock tax is as defective as the excess-profits tax, but the matter is not so serious because the rate is low.

The practical problem that will come before you is likely to be this: Do you want to keep the excess-profits tax for a single year? If you are going to keep it indefinitely, new efforts should be made to remedy its defects and make it a workable tax. That is one thing. But if you propose to keep it for a single year, when it is going to yield a comparatively small amount and when the defects in operation will be particularly accentuated, that is another thing.

Senator SIMMONS. I want to ask Dr. Adams this question: Do you see any reason, outside of the reason which you have given to the committee, why the excess-profits tax is not as a system sound and equitable?

Dr. ADAMS. My impression is that Secretary Mellon thinks that the whole principle is wrong, as did Secretary McAdoo. Administratively, it is very difficult. Secretary Houston said that it had brought the Bureau of Internal Revenue to the verge of an administrative breakdown. Furthermore, it is applicable to only one class of business concerns—corporations. Finally, it is losing its productivity.

Senator SIMMONS. The Secretary has said that the amount which we are realizing from excess profits is dwindling and has already been greatly reduced. That is true. The present conditions are not favorable to excess profits. Yet large excess profits are being made. Profits in excess of 8 per cent are being made to-day by some corporations. I suppose there will be a turn in the affairs of the country and that we shall get back to a normal and prosperous condition in this country. Will the Treasury then receive a reasonable amount of revenue from this tax?

Dr. ADAMS. I think it would, unquestionably; but I also think that the inequality of this tax perverts it.

Senator SIMMONS. If in these conditions a few corporations are paying this tax, then the stagnation is not the result of the tax, is it?

Dr. ADAMS. I do not believe the stagnation is the result of the tax.

Senator SIMMONS. Suppose we were to-day upon a basis of prosperity. Would we not receive a large income from the excess-profits tax?

Dr. ADAMS. I think we would probably receive around $1,000,000,000. I have no question about the productivity of the tax.

Senator SIMMONS. Do you think that the fact of the excess-profits tax is going to very seriously retard a return to prosperous conditions?

Dr. ADAMS. I think the excess-profits tax would seriously retard it, because it works so unjustly. Corporations paying it know that other corporations, in all essential facts like them, pay nothing. It introduces unfair competition. Corporation A pays a heavy tax, 20 to 40 per cent, alongside of Corporation B which is exempt, substantially; the whole condition turning on accidents of financial conduct, whether they have or have not reorganized, and that sort of thing.

Senator McCUMBER. Dr. Adams, will you express your opinion as to th feasibility or propriety of repealing the excess-profits tax against any corpora

Dr. ADAMS. All the distribution, Senator?

tion conditioned upon the distribution of the excess earnings of the corporatio in a greater amount than 8 per cent?

Senator McCUMBER. Less a reasonable amount retained and necessary for th safe conduct of the business.

Dr. ADAMS. I think e could enforce such a law. From an administrativ standpoint, it would be practicable. I do not believe, however, that it is at al desirable, because you retain the defects of the excess-profits tax in you scheme. My objection to the excess-profits tax is that you do not in fact an in practice tax in a fair measure what should be called excess profits. Ther would be corporation after corporation—and large ones at that—which woul not come under the excess-profits tax. That is one fundamental objection to it

Senator McCUMBER. But every corporation could relieve itself from th excess-profits tax if it made a distribution of its profis over and above wha was actually necessary for the conduct of the business, and the amount dis tributed would, in many instances, if not in most instances, yield the Gov ernment revenue by virtue of the income tax on individuals.

Dr. ADAMS. Senator McCumber, that touches only a part of my objection There might be relief to the corporation that was unjustly taxed under thi situation. There would not be a cure of an equally important defect—th failure of the excess-profits tax to reach the corporations which should b taxed. That is the thing that causes unfair competition between those whic are taxed and those which are not taxed. Secondly, it would have all th administrative difficulties of the present system. And there would be som more, although those new administrative difficulties would not be in themselves fatal. Thirdly, I share the feeling that it is not wise to force corporations t distribute earnings. I think it is good for business concerns to plow back a large part of their earnings.

Senator McCUMBER. After the capital is distributed it goes into the hands of the distributee. He has to do something with it. Wouldn't he be likely to invest it?

Senator SMOOT. I would like to have a law compelling corporations to use a certain amount of their earnings or to retain a certain amount of their earnings. That is a good provision for the protection of the stockholders.

The CHAIRMAN. Gentlemen, we have with us now the Secretary of the Treasury. The committee failed to call to the attention of the Secretary, although he has had it in mind and has mentioned it, the increase to $7,500,000,000 in connection with the second Liberty bond act.

Senator SIMMONS. I wish, Dr. Adams, you would read that provision.

Dr. ADAMS:

"Subdivision (a) of section 18 of the second Liberty bond act, as amended, is amended by striking out the words and figures 'For the purposes of this act, and to meet public expenditures authorized by law, not exceeding in the aggregate $7,000,000,000,' and inserting in lieu thereof the words and figures 'For the purposes of this act, to provide for the purchase or redemption of any notes issued hereunder, and to meet public expenditures authorized by law, not exceeding in the aggregate $7,500,000,000 at any one time outstanding.'"

Secretary MELLON. In order to understand this it is necessary to get the distinction between Treasury certificates and Treasury notes. They are practically the same thing, except that the Treasury certificates are limited to one year, while Treasury notes are limited to five years—not less than one year and not more than five years.

The Secretary of the Treasury, under the second Liberty bond act, is authorized to borrow from time to time on the credit of the United States, for the purposes of this act and to meet public expenditures authorized by law, such sum or sums as in his judgment may be necessary, and to issue therefor certificates of indebtedness of the United States at not less than par in such form or forms and subject to such terms and conditions and at such rate or rates of interest as he may prescribe; and each certificate so issued shall be payable at such time not exceeding one year from the date of its issue, and may be redeemable before maturity upon such terms and conditions, and the interest accruing thereon shall be payable at such time or times as the Secretary of the Treasury may prescribe. The sum of such certificates outstand-

ing hereunder and under section 6 of said act approved April 24, 1917, shall not at any one time exceed in the aggregate $10,000,000,000.

There is ample money and ample authority to issue one-year certificates, but under the program of the Treasury, as stated in the letter to the Ways and Means Committee of the House under date of April 30, it was the thought that instead of continuing to carry along or roll along this floating debt indefinitely in these short-time certificates we would issue from time to time notes of longer date. We have already made one issue of three years. The object is to make the early maturing debt more manageable. If we continue with these short-date certificates and wait until the Victory loan matures, we shall get such an enormous amount rolled up together that to a considerable extent it will be more difficult to manage. In other words, it gets to be too large a sum to ask the public or the banks to meet at maturity. Therefore it was proposed that we should issue to a certain extent short-term notes and extend the maturities between the present time and 1928, when another issue becomes due, with the idea that in the interim there will be a place—possibly next year or the year after that—when the financial condition of the country will be such that money may be obtained for a comprehensive refunding. There will be a place where this debt ought to be refunded on a comprehensive scale.

Senator SIMMONS. I notice that you ask for an authorization to issue $500,000,000 more than you were authorized to issue before.

Secretary MELLON. Yes; I am coming to that.

As I say, these are all short-term certificates, and if we keep on in that way it will be difficult to manage. We have to take into consideration first the two and three-quarter billions of floating debt that we have. Then there is the Victory-note debt of about $4,000,000,000 that comes due within two years. There are also the war savings certificates. Altogether that makes practically $7,500.000,000 of floating debt which comes due from month to month. If we had to rely entirely on one-year certificates, we would soon get such a large amount that we would be taxing the resources of the banks too greatly at one time. The plan therefore is to distribute the debt over a longer period and keep it in manageable shape, so that when the opportunity arrives for a comprehensive refunding program everything will be in shape for that and we will not have too large an amount against us at any one time.

Senator SMOOT. Just what were the figures you gave?

Secretary MELLON. There are about $4,000,000,000 of notes. There has been one issue of the new notes put out. We are preparing now for the maturities that come on the 15th day of the present month. We have all ready to get out to-day, I think, an offering of $600,000,000. As to that offering of $600,000,000, we are asking for tenders for three-year notes and one-year certificates as well as for six-month certificates. The object in asking for tenders for the three classes is largely this: The short-term certificates come out at lower rates of interest. For instance, the six-month certificates will be at 5 per cent, the year certificates will be at the rate of 5¼ per cent. and the three-year notes at 5½ per cent. When we get those tenders there may be oversubscriptions, and then we will select according to requirements possibly a large proportion of the longer notes. It puts us in shape to do our best in the way of rates of interest and also making maturities so that they will come in reasonable amounts.

In October we will have to meet this same sort of situation. This comes along from month to month. You can see when we are asking for $600,000,000 now that if we had everything in sort-dated certificates we would have two or three billions in amounts that would be difficult to treat with.

We have already authority for these notes from one to five years, but the amount is not sufficient. The authority is here, as follows:

"* * * The Secretary of the Treasury, with the approval of the President, is authorized to borrow from time to time on the credit of the United States for the purposes of this act, and to meet public expenditures authorized by law, not exceeding in the aggregate $7,000,000,000, and to issue therefor notes of the United States at not less than par in such form or forms and denomination or denominaions, containing such terms and conditions, and at such rate or rates of interest, as the Secretary of the Treasury may prescribe, and each series of notes so issued shall be payable at such time not less than one year nor more than five years from the date of its issue as he may prescribe, and may be redeemable before maturity, etc."

While we have $7,000,000,000 authorized there, there are already outstanding about $4,000,000,000 of Victory notes, which absorb $4.000,000,000. Then, as I

say, we put out a few hundred million a month or so ago, and we are putting out a certain amount now. So there was a question that the $7,000,000,000 might not cover this all.

The authority that we have for this $7,000,000,000 of notes is ample authority until we reach a place where we may have to absorb what the Victory notes take up and what we issue. But you can readily see it is not a new debt in any way; the public debt is not increased. On the other hand, it is a transfer from shorter certificates or other maturing debt into notes. We have authority for all that is needed in short certificates, not longer than a year, but as we transfer over into longer maturities a certain amount will run to a place where, considering victory notes outstanding, that amount may not be enough, so that in order to go along with this program of rolling this debt along and keeping it in manageable shape this authority was asked for an increase from $7,000,000,000 to $7,500,000,000. It is not very much different. It is only $500,000,000 more of the same authority that we already have up to $7,000,000,000; that is there will be no occasion for anything new in connection with it, except just to expand the amount that we have authority for now.

Senator SMOOT. The expansion of the notes will simply mean the contraction of the short-time certificates to the same extent?

Secretary MELLON. Exactly. As to these notes, when there is a larger amount outstanding there will be a lesser amount of other short-dated debt. It is the same thing exactly that we have now, except that in calculating what we may run into it occurs to us that the authority might be scant. We thought that if we reached such a place we would then have no more authority and would have to go to Congress, and therefore it was believed desirable and well to ask for the authority here.

Senator SMOOT. Do you remember the amount of the short-time certificates authorized to be issued?

Secretary MELLON. We have authority for $10,000,000,000, which is a great deal more than is needed. I do not mean that there is room in the $10,000,000,000 for the other short-dated debt over and above the two and three-quarter billions of floating debt, but we have under the short certificates more than $6,000,000,000 of leeway.

Senator SMOOT. At least that much?

Secretary MELLON. Yes. To-day, with the Victory notes that were originally issued, and with the notes that are longer than one year added to that, it leaves, out of the $7,000,000,000 that we have authority for already, about two billions yet to issue. In other words, to-day we have only $2,000,000,000 margin to go on in transferring the short, less than one year certificates, into the longer notes. The added $500,000,000, making the authority extend up to $7,500,000,000 at any one time outstanding, will give the authority needed for notes.

Senator WATSON. There is no purpose other than to use this authority in the way it is prescribed?

Secretary MELLON. No. In the first place, we have no more authority than the act gives—that is, for taking care of the public debt as authorized by law or for meeting maturities—and there is not any occasion, or will not be any occasion, for anything else, unless Congress makes occasion for it.

Senator SIMMONS. You say there will not be any occasion. I sincerely hope that there will not be, but I want to ask you this question:

On yesterday you recommended to the committee that it would be necessary to levy taxes to pay the full amount Congress has appropriated for the departments of the Government, and the amount that you said it would not be necessary to raise by taxes was several hundred millions of dollars. That recommendation, as I understood it, was based upon the theory of pursuance of this understanding had between the President and the heads of the different departments to the effect that they would economize to such an extent that they would not have to use the full amount of the appropriations made. Suppose, now, that plan miscarries; suppose the departments do have to use these full amounts appropriated; we have not levied enough tax to bring in an income sufficient to enable them to do that, so there will be a deficit of several hundred millions of dollars. Under this provision of the bill increasing the amount authorized—it was $7,000,000,000 and now it is $7,500,000,000—would there be anything in the way of making up this deficit in revenue by issuing these notes and borrowing money? It says here, "All public expenditures authorized by law." This would be a public expenditure authorized by law.

Secretary MELLON. Yes.

Senator SIMMONS. Because it was made by an appropriation. Why couldn't you, under that act, borrow that money under the authority conferred upon you to issue these notes for public expenditures authorized by law?

Secretary MELLON. Of course, if there is that sort of necessity, it would be obligatory or necessary for us to issue them.

In regard to the question which you have brought up—the statement that we expect to get along with the amounts that the deparments have agreed upon—let me say to you that, in the first place, the Director of the Budget Bureau is keeping in close touch with that. He is carefully watching these items and the requirements of the different departments. He is keeping in touch with the whole matter.

This morning I was at a cabinet meeting, and I remembered the question that was raised here yesterday as to whether or not some of these departments, having agreed to this, might go on and incur additional expenses, and so on. I also brought up the question raised here to the effect that the Agricultural Depaartment might cut off $25,000,000 for expenditures for good roads, while Congress had provided and directed that that money be expended in that direction. The situation is this as explained by the Secretary of Agriculture. The reason that the Department of Agriculture could cut its appropriation was——

Senator SIMMONS. What appropriation—the roads appropriation?

Secretary MELLON. No; all the appropriation. The Secretary of Agriculture cut it down $50,000,000. That was brought about in this way.

Senator SIMMONS. $50,000,000 was more than was appropriated.

Secretary MELLON. $25,000,000, I should have said. I was thinking of the War Department.

The reason that the Department of Agriculture expected to be able to make this cut was not through the avoidance of any expenditures that they were under any obligation to make, but resulted from coordination of supplies, which enabled the War Department to turn over to the Department of Agriculture an enormous amount of supplies available for road-making purposes. That was a very large amount, and that took the place of purchases that otherwise the Agricultural Department would have had to make. With the use of the supplies that were unnecessary in the War Department the Agricultural Department could go along and use these supplies and thereby avoid that additional expenditure.

When the original estimate was made in the Agricultural Department they did not know that they were going to use these supplies from the War Department. They did not know that they existed. But there has been in regard to supplies a general spirit of coordination among the different departments, so that where one department can use any supplies of which another has a surplus that surplus is turned over. In this particular case—and I mention it because I have referred before to the Department of Agriculture—the War Department had transferred over to them a large amount of supplies. Now, from all that I could gather these cuts made by the various departments have been legitimate economies that have been brought about largely through that coordination, and I do not think there is anything to fear.

Senator SIMMONS. That is extremely interesting to me in view of the fact that the Congress has directed the War Department to turn over these war supplies for road-building purposes to the Agricultural Department. How could the Agricultural Department turn them over to the States, not for a consideration but as a contribution?

Secretary MELLON. I do not know anything about the question of the States.

Senator CURTIS. We have thrashed that out in the Senate.

Secretary MELLON. Whatever the situation is, it has saved the Agricultural Department from going out and buying these supplies that they would require.

Senator CURTIS. Supplies that appropriations were made for?

Secretary MELLON. Yes; supplies that appropriations were made for. So that it does not make any difference what the ultimate destination may be, the situation was that the Agricultural Department needed those supplies and would have used a part of its appropriation for purchasing those supplies, but having been able to obtain them from the War Department without paying for them, because they were transferred, they could then do with a less appropriation and thereby cut down their estimates.

Senator SIMMONS. We appropriated, in addition to these war supplies that the department was required to turn over, $75,000,000. Whatever the turn-

over was, they charged the States nothing for it. It does not in any way diminish that $75,000,000 that the Government has to contribute to good roads.

Senator SMOOT. The legislation you speak of, Senator, had reference only to trucks and nothing else.

Senator CURTIS. That statement was made on the floor, that it applied only to trucks.

I understood the Secretary to say that before they found there was an extra supply in the War Department the Agricultural Department sent in an estimate and the appropriation was made. After the appropriation was made, they discovered certain supplies could be had free from the War Department, and they were then gotten from the War Department free of charge.

Senator SIMMONS. In the bill that passed the other day we did not confine our instructions to the War Department to trucks. We made it embrace every material in its possession.

Senator MCCUMBER. That was a grant to the States, not to the entire department.

Senator SIMMONS. No. They directed the War Department to turn over to the Secretary of Agriculture and then directed the Secretary of Agriculture to turn it over to the States.

Senator CURTIS. But this was the roads bill that you refer to. There was appropriated in the Agricultural bill that passed the short session $25,000,000 for the purchase of articles that they did not know were in the hands of the War Department. Now they can go and get them without paying for them, and we can save that $25,000,000.

Senator WATSON. I think we have gone rather far afield as to that appropriation, anyhow.

Senator SIMMONS. I brought that up for the purpose of showing that if we did not levy enough taxes to pay these appropriations, and these appropriations were found to be absolutely necessary to run the Government, that we had in this bill provided a means by which the Government could go out and sell securities. That was the only purpose.

Senator SMOOT. But this amendment has nothing to do with that. They could have the certificates in different amounts instead of notes. There is authority to issue certificates.

Senator SIMMONS. What I am saying is that here is authority by which the Secretary of the Treasury could borrow any money that is necessary.

Senator SMOOT. But he has that already.

Senator SIMMONS. But you are asking to enlarge it.

Secretary MELLON. We desire only to have the authority enlarged as to longer-term notes. We could do the same thing you speak of if we had legal authority. We could use money for the requirements of the Government. We have authority now. In other words, this increase of $500,000,000 has no bearing on the question you raise at all.

Senator SIMMONS. It is for that purpose, you say.

Senator SMOOT. They could not go beyond what we have already appropriated.

Senator SIMMONS. I say that if you do not effect these savings that you have been talking about and if you should have to spend the full amount of the appropriation, as we have not appropriated enough to pay the full amount, here is authority by which the Secretary of the Treasury could borrow the money. He says he does not put it in for that purpose, but he has the authority.

Senator WATSON. If there were the necessity he could take short-term notes now without this authority.

Senator SIMMONS. It brings out what I had in mind.

Senator MCLEAN. Mr. Secretary, I would like to ask you a question: What do you estimate will be the requirements of the War Finance Corporation?

Secretary MELLON. It is not expected that there will be any requirements imposed on the Treasury Department so far as the War Finance Corporation is concerned. The further expenditures that they may make will be obtained, it is understood, through the placing of the securities that the railroad administration already has.

Senator MCLEAN. They will require no additional funds from the Treasury?

Secretary MELLON. No; it is expected that the expenditures of the War Finance Corporation will not affect the Treasury Department.

The CHAIRMAN. I would like to ask a question on which my mind is not fully clear, and I think some of the members of the committee may likewise desire enlightenment. We were talking about the matter before you came here. In case of the elimination of the excess-profits taxes and the reduction of

revenues through other acts of this committee, how are we going to make up the losses in revenue? I would like to have that situation clarified somewhat.

Secretary MELLON. The statement that is printed here gives the items that have been suggested as substitutes for that.

Senator WATSON. He has a statement there making it up, lacking, however, $16,000,000 for a half year and some $50,000,000 or $60,000,000 for the whole year, without any explanation as to how that is to be made up.

Secretary MELLON. It is this way: For the fiscal year 1922 the corporation tax—the increase in the corporation tax recommended, making it 15 per cent—realizes $100,000,000; the transportation tax, or retaining half of that tax for the year, makes it $65,000,000; and the smaller items taken altogether make a total of $234,000,000, or within $16,000,000 for the fiscal year, of all that is wiped out by the elimination of the excess-profits tax and these other items.

For the calendar year the items make up $414,000,000, which leaves a shortage of $95,000,000 for the calendar year, if the estimates are reliable. There are, however, a great many contingencies, such as that of the railroad requirement of $495,000,000 within the calendar year. That is not likely all to be required in the calendar year, and therefore it does not seem necessary to supply any new source of revenue, any new tax, to make up the $95,000,000. If the new tax were required, we would suggest an increase in the documentary stamp tax, which would make up approximately that amount, but we do not think that that is necessary. We think that during the calendar year the revenues will be sufficient to meet the requirements, as shown in the other table.

The CHAIRMAN. Without a new tax?

Secretary MELLON. Without a new tax.

The CHAIRMAN. That is an important point, I think, to be taken into consideration.

Senator SIMMONS. I want to ask the Secretary one question. I notice in this statement you propose the repeal of the excess-profits tax and that you propose to retain one-half of the present tax upon transportation.

Secretary MELLON. Yes.

Senator SIMMONS. You are going to repeal the excess-profits tax on the ground that it is repressive of business. I want to ask you if you think the excess-profits tax is any more repressive than these charges upon tranportation? Is there anything that bears more upon the economic conditions and trade conditions of the country? Is there any more reason why the excess-profits tax should be repealed than there is why the transportation tax should be repealed? I know in many sections of the country these transportation charges are regarded as the worst possible clog upon business.

Secretary MELLON. Yes; but that is only a tax on the transportation charges, which is a very small percentage.

Senator SIMMONS. But you are adding to that.

Secretary MELLON. No.

Senator SIMMONS. I do not mean adding to that tax, but you are adding the burden of that tax.

Secretary MELLON. No; that tax is in existence and has been. The railroads collect those taxes from the passenger traffic and from the freight traffic. What is the percentage?

Dr. ADAMS. Three per cent on freight and 8 per cent on passengers.

Secretary MELLON. Those are the percentages, and they are not burdensome and the people are accustomed to it. This cuts that in two, which will make it 1½ per cent on freight and 4 per cent on passengers for the first year, and then the tax is to be eliminated entirely. It only means that for one more year, with half of the present burden, which would be 1½ per cent on freight and 4 per cent on passeengers. It is distributed over all the traffic of the country.

Senator SIMMONS. But the man who pays the passenger fare has to pay the tax and the man who pays the freight has to pay the tax.

Secretary MELLON. He only pays half the tax he is accustomed to.

Senator SIMMONS. You are cutting it half in two. You might apply the same principle to the excess-profits tax.

Secretary MELLON. You can, but there is a good deal to be said in favor of a tax that the people are accustomed to. It is cut in two. The same method of collecting will exist for collecting half of it as when all of it was collected. The railroads are accustomed to it. The tax has been in existence for some time. They are relieved to the extent of one-half. It is widely distributed over all commodities of all kinds.

Senator SIMMONS. It will cost as much to collect one-half as it would to collect the whole.

Secretary MELLON. It does not cost the Government anything to collect it. The railroads have been collecting the tax and remitting it to the Government.

Dr. ADAMS. May I suggest that the addition of 5 per cent income tax upon corporations is more than half the excess-profits tax. You are doing substantially the same thing for both. The transportation tax is cut in half, and this particular corporation tax is cut in half. The only difference is that the 5 per cent on corporations will go on indefinitely, and the transportation tax goes off altogether on December 21, 1922. You relieve the excess-profits tax reduction by keeping half the transportation tax on for a year. You have not taken into account the additional 5 per cent corporation income tax. It is somewhat larger than half the excess-profits tax. Moreover, it will continue indefinitely, while the half of the transportation tax that is retained only continues for another year.

Senator SIMMONS. Let me ask you, Dr. Adams, at this very point, you have not given us any figures as to what extent the increase of the corporation income tax to 15 per cent will balance the repeal of the coroporation excess-profits tax.

Senator WATSON. Yes; he has given all the figures in his statement.

Dr. ADAMS. The figures are that the excess-profits tax will possibly yield $450,000,000 a year for the calendar year 1921; that the additional 5 per cent income tax for that year will yield $267,500,000.

Senator WALSH. Corporation income tax?

Dr. ADAMS. Corporation income tax.

Secretary MELLON. It is already 10 per cent, and this is adding 5.

Dr. ADAMS. I differ with Mr. McCoy always with the greatest reluctance, but, in my opinion, the 5 per cent tax would yield more than the excess-profits tax. I always differ from him with trepidation, but that is my personal opinion.

Secretary MELLON. I agree with Dr. Adams on that. On account of the condition of business there are so many that will not run into the liability of the excess-profits tax; and the flat tax, which is a tax on the profits of the corporation, I think will be pretty close to amounting to the same thing. At any rate, the principle is the same. The transportation tax is relieved to the extent of one-half, and it is more equitable, more broadly distributed, more uniform. It makes it better and less burdensome generally to industry.

Senator SIMMONS. You are primarily, however, proposing to repeal the excess-profits tax, because you say it is a burden, not because you are substituting some other tax for it. You are repealing it because it is a clog to business?

Secretary MELLON. Because it is inequitable.

Senator SIMMONS. I want to say, in regard to cutting transportation tax in two, I think that is a very bad thing to do. I think we ought to repeal it altogether and find some other tax to take its place.

Secretary MELLON. It is very widely distributed over everything that is transported, passenger and freight, and it is a very small percentage.

Senator SIMMONS. I know it is a very small percentage, but, my dear Mr. Secretary, the people of this country are having to pay a transportation rate that is absolutely oppressive.

Secretary MELLON. Exactly.

Senator SIMMONS. And it is not only repressive of business, but it is destructive of business, and if we can relieve them of any part, however small, of that enormous and oppressive charge we should do it.

Secretary MELLON. Yes. The answer to that is that this tax is so insignificant compared with the burdensome tax you speak of, because there is great unevenness in the traffic charges of the country. The horizontal raise in rates put rates out of proportion, and they are a great burden, but that tax is so infinitesimal and insignificant in comparison to it that it is really negligible.

Senator SIMMONS. I would rather repeal it and put on the old documentary stamp tax.

Secretary MELLON. That could be done, but it is shifting to another tax.

Senator WATSON. What would you say as to the relative merits of a tax on postage of $140,000,000? Mr. McCoy says one more penny on postage would raise $140,000,000.

Secretary MELLON. About $75,000,000 or $80,000,000.

Senator WATSON. And the stamp tax $20,000,000?

Secretary MELLON. No. The documentary-stamp tax would be somewhere about the same as the postage. Well, it depends upon what percentage you make it, but it is feasible to get about $60,000,000 from that.

Senator WATSON. I always understood one more penny on postage would make $70,000,000, but Mr. McCoy said $140,000,000.

Secretary MELLON. That is right.

Dr. ADAMS. Let Mr. McCoy state that.

The CHAIRMAN. I wish the committee would cease having two or three conferences at one time.

Mr. MCCOY. That is the increase of all postage, not merely first class.

Senator SMOOT. Postal cards and all?

Mr. MCCOY. Yes.

Dr. ADAMS. The $70,000,000 covered postal cards with 2-cent stamps.

Senator CURTIS. What do you say, Mr. Secretary, you could get from the documentary-stamp tax?

Secretary MELLON. About $60,000,000.

Senator CALDER. What do we get now from that tax?

Dr. ADAMS. There are a number of them. They all aggregate about $80,000,000.

Secretary MELLON. About $80,000,000.

Dr. ADAMS. On some of those you might not want to double the rates. Doubling the rates would probably bring $60,000,000. You could add a class or two if you wanted to bring it up to $70,000,000. The transfer of stocks is taxable, and the transfer of bonds are not. If you want to put in the transfer of bonds you could carry it up $5,000,000 or $10,000,000 more.

Senator WATSON. What is your opinion of the relative merits or demerits of the two taxes.

Dr. ADAMS. Transportation and document?

Senator WATSON. Yes.

Dr. ADAMS. I think they are both good taxes of the general class in which they are. I feel that there is always an argument in favor of the tax that is on. If we had the documentary-stamp tax on, I would favor keeping that rather than the transportation tax.

Senator MCCUMBER. You must bear in mind that we have increased our transportation rates enormously, about three-fourths in many instances, and when you add the tax to that, which is already great, it makes it still more unbearable.

Senator WATSON. One of the crying needs of the hour is a reduction in railroad rates, and one of the great deterrents to the restoration of prosperity is our present railroad rates. If the other tax would be less burdensome to business and have a less deterrent effect upon its revival, it seems to me it would be a good thing to substitute it.

Secretary MELLON. Senator Watson, there is no doubt in my mind but that the increase in the postage rates is a better placing of the burden than on the transportation; but the reason the transportation tax was selected, the retention of one-half of it, was that it is already going, and there seemed to be such an opposition to placing any new tax. That is the only reason for it. For instance, if there had been no transportation tax and no stamp tax it certainly would be preferable to select the stamp tax. It is a more desirable tax. But you do run into that general opposition, and what that amounts to I do not know, but it seemed in the House to be very strong, and therefore it seemed more prudent to say we would retain half the transportation tax, it being widely distributed, and that would be a more feasible thing than to adopt a new tax like the stamp tax. But the stamp tax is a good tax.

Senator WATSON. In the House they repealed it all; wiped it all out.

Senator SIMMONS. Your suggestion is the restoration of half of it, to the extent of one-half?

Secretary MELLON. Our recommendations to the House were practically as they are made here, but they put in the clause canceling it entirely.

Senator CURTIS. You already have documentary stamp tax?

Secretary MELLON. We already have; but that rate can be raised without being excessive. They are very small. What is the rate?

Dr. ADAMS. It differs. It is 2 cents on $100 for most things. That is one-fiftieth of 1 per cent.

Secretary MELLON. To double it would be one twenty-fifth of 1 per cent.

Dr. ADAMS. A few of them should not be doubled, but many could be doubled.

Senator MCLEAN. Would it be feasible to remove the transportation tax entirely on freight and leave the tax on passenger transportation in the law, and substitute for the loss that would be occasioned by removing the tax a tax on documents?

Senator CURTIS. But, Senator, as I understand it, the transportation tax is $65,000,000. By doubling the document tax, without any extra stamp tax, you could raise that amount of money.

Senator WATSON. $130,000,000.

Dr. ADAMS. For a year it is $262,000,000. You can not get rid of the great difficulty connected with the fiscal year. Putting it on an annual basis, the transportation tax yields $262,000,000. The tax for one-half a year would be $131,000,000, and cutting the rate in two would bring the loss to $65,000,000.

Senator CURTIS. The documentary tax doubled would not bring more than $70,000,000 a year.

Dr. ADAMS. It would not bring more than $70,000,000 a year.

Senator MCLEAN. What proportion of the transportation tax is on freight and what proportion is on passengers?

Mr. MCCOY. Freight is the larger.

Senator WATSON. As far as I am concerned, I would like to reduce the burden on railroad traffic.

Senator MCCUMBER. It seems to me we can find some way to get rid of it entirely.

Secretary MELLON. There are two ways in which we could conveniently do that. We could do it by adding the increased postage rate and by adding to the documentary stamps. Those two would make it. Or you could leave the stamp question out altogether and raise the tax on automobiles, or something like that, which is widely distributed. There is another stamp tax upon bank checks, 2 cents for each check, which would amount to about $45,000,000; but there is a strong reaction in the South and West against the bank-check tax.

Senator MCCUMBER. Not so much for the amount as for the inconvenience and the question of deposits.

Secretary MELLON. Yes.

Senator CURTIS. All my letters have been on the question of deposits.

Senator MCCUMBER. That goes right back to the inconvenience. The depositor, who may be a small depositor, will want to issue a check and has no stamp. He may be out in the country and can not get them conveniently. It is not the amount involved. It is the nuisance of having to hunt up some stamps somewhere.

The CHAIRMAN. Senator Simmons, my recollection is that the southern Senators and Representatives do not want a tax on checks.

Senator SIMMONS. I do not know of any who do.

The CHAIRMAN. I understood that was your attitude in the last bill.

Senator SIMMONS. Yes; we bitterly opposed it.

The CHAIRMAN. You are opposed to it?

Senator SIMMONS. Yes. I understand as a rule that the Senators from the West are opposed to it.

Senator SMOOT. We certainly are.

The CHAIRMAN. I think it ought to be dropped if that is the view.

Senator GERRY. What would the stamp tax bring in?

Dr. ADAMS. Forty-five million dollars at 2 cents.

The CHAIRMAN. I think it is too cheap. We get too many letters. The community could get along just as well with less letter writing.

Senator SMOOT. If you put the increased tax on, everybody will feel it.

The CHAIRMAN. Mr. Mellon, have you any other thought to leave with the committee?

Secretary MELLON. I do not know of anything further.

The CHAIRMAN. It is in a molten mass now to put in shape.

Secretary MELLON. If there is anything further desired I am ready at any time.

The CHAIRMAN. We want all the help we can get.

Secretary MELLON. Just call me on the telephone and I will appear at any time I can be of any benefit.

Senator SIMMONS. I want to inquire if the Treasury Department has had estimates made as to the relative amount of taxes to individuals and partnerships, as compared with corporations, if you repeal the excess-profits tax and raise the corporation income tax to 15 per cent? We have had a good deal of trouble trying to equalize taxes between individuals, partnerships, and corporations. I would like to get the information from Mr. McCoy, or whoever in the Treasury Department can give it, as to what would be the condition with reference to equality and parity if we make these changes that are now contemplated.

Senator SMOOT. You mean the 15 per cent?

Senator SIMMONS. I mean the 15 per cent on corporation incomes, and repeal the excess-profits tax. What would be the parity between the corporation income tax and the partnership and individual income tax?

Dr. ADAMS. You understand, Senator, that could only be done by a large mass of different kind of cases. It is very easy to do that, but you can not get any one answer. If the corporation is earning a small rate, one thing will happen; if it is earning a high rate, another thing will happen. If the particular partnership or individual has a large income, one answer comes; if it has a small income, another comes. We would be glad to get you up illustrations, but you can get any answer you want from the illustration and find a particular case to fit it. If you can get what seems to be a typical case, it will work out.

Senator SIMMONS. When we were framing this bill Mr. McCoy gave us a good deal of information with reference to the disparity, and we tried to change the bill and did change it with a view to bringing about parity or something approximating parity, as a result of the information which Mr. McCoy gave us.

Senator WATSON. If Mr. McCoy has an opinion about it, I would like to have it.

The CHAIRMAN. We will let Mr. McCoy have an opportunity to state his response to Senator Simmons's question.

Mr. McCOY. It is very easily answered within limitations. The maximum possible tax that a corporation would pay under the proposal of the Secretary would be 15 per cent; the maximum possible tax that a partnership or an individual would pay, under the Secretary's proposition, would be 33 per cent. If the corporation has a very large income it would pay approximately 15 per cent, and the individual pay 33 per cent. Of course, it goes down to nothing. In the case of the corporation it ranges between nothing and 15 per cent; in the case of the individual or copartnership it ranges between nothing and 33 per cent.

Senator SMOOT. You do not want to stop there with your answer, do you?

Mr. McCOY. What further could I say?

Senator SMOOT. You could say that after the 15 per cent is taken out that is distributed and the individual that receives it comes under the income tax.

Dr. ADAMS. Add the surtax.

Mr. McCOY. Those are the limits. If the corporation had a large number of stockholders, so none of them would pay any other tax, the 15 per cent would be the maximum limit.

Dr. ADAMS. When they distribute it the stockholders have paid through the corporation 15 per cent, and then they pay whatever surtax applies.

Mr. McCOY. If there are not enough stockholders, so they would not pay any income tax, that would be all the earnings of that corporation. Those are the limits.

Dr. ADAMS. I want to bring out one other thing that is in your mind but not in the minds of the committee.

In the case of a member in a partnership having an income, of a size which does not get him within the 15 per cent bracket, the corporation pays more than the partnership. You do not reach the 15 per cent rate until you get up to $15,000 or $20,000 a year. Many members of partnerships do not have that income, and they pay a less tax than they would pay through a corporation.

Mr. McCOY. Under the present law a partnership with a large income will pay more.

Dr. ADAMS. You can get almost any answer, depending upon the particular case, and then you have to make up your mind what type of cases you are interested in.

Senator SMOOT. You gave the limitations without any distribution of the stock on the part of the corporation. Take any individual business making 15 per cent, and a corporation making a 15 per cent profit; the individual has no other tax to pay at all, but as soon as the corporation distributes that to the individual stockholders then they are taxed on their income, and it is against the corporation. There is no doubt of it in my mind, taking the country as a whole. We tried to equalize it when we made the difference of 4 per cent in the flat tax. That was to equalize corporations doing business with individuals doing business. I do not think it did equalize it. I think the individual was discriminated against. But with a flat 15 per cent tax upon corporations, upon their business as a whole in the United States, the corporation would be discriminated against.

Senator SIMMONS. I would like to ask Mr. McCoy, just speaking generally, if he thinks that is true.

Mr. McCoy. It is true if the distributions are large enough to pay considerable income tax, but a great many corporations, probably 30 per cent, have no dividends paying an income tax for the individual.

Senator Smoot. You mean the dividend is not large enough for them to pay?

Mr. McCoy. The people that receive them do not have large enough incomes.

Dr. Adams. If they do not have a surtax, they do not have any additional tax.

Senator Smoot. Certainly. I know that.

Senator Simmons. What percentage do you say do not pay any income tax?

Mr. McCoy. Something less than 30 per cent.

Senator Simmons. Something less than 30 per cent pay no income tax?

Mr. McCoy. Yes. They have to receive over $5,000 dividends to pay income tax.

Secretary Mellon. The normal tax is paid by the corporation?

Dr. Adams. It is bigger than the ordinary normal tax. It is proposed now to be 15 per cent, and the normal in case of an individual never goes beyond 8, and up to $4,000 it is only 4 per cent.

There is another element in this—the corporations have their capital stock tax to be taken into consideration.

Senator McCumber. There is another thing that is not taken into consideration, Dr. Adams, and I think it is very important. There is no way by which the partnership gets around paying on its full earnings. Not only that, but each individual in that partnership is personally responsible for every dollar of debt, and that very responsibility ought to give him some advantage over the corporation plan. Otherwise, it would benefit all of them to go into the corporation plan.

Senator McLean. The corporation tax is paid by the stockholder in the long run.

Senator McCumber. Of course it is paid by the stockholder.

Dr. Adams. I do not want to be understood as attempting to explain away a problem that is very real, I simply want to show that you can not get a satisfactory answer to that inquiry. You will have numerous separate cases in which the answers are different, and then you must make up your minds which case you regard as the most important.

Senator Simmons. I think it would be very helpful to the committee if you and Mr. McCoy would work that out and give us a typical case, and we can make the application of it.

Senator Smoot. Senator Simmons, Dr. Adams, or Mr. McCoy will not state for a moment that on profits made upon an individual business up to 15 per cent, or anything less than 15 per cent, the individual has the advantage.

Dr. Adams. It is not 15 per cent, Senator.

Senator Smoot. It is 15 per cent of the profits.

Dr. Adams. It depends upon the size of the income.

Senator Smoot. I am talking about the business that the individual does.

Dr. Adams. His tax will not depend upon whether that is 15 per cent or less or more; it is the size of the income that determines the rate.

Senator Smoot. It falls within the bracket of the income up to 15.

Dr. Adams. Yes; if it is big enough to go into 15 per cent bracket.

Senator Smoot. Therefore it makes no difference whether it is $1,000 or $100,000, it is 15 per cent?

Dr. Adams. On the corporation?

Senator Smoot. On the corporation.

Senator McCumber. Take a typical case. Here is a corporation that makes $100,000. It has 100 stockholders. That is $1,000 apiece. Those stockholders who receive that dividend do not pay anything out of that. They pay no tax on that. All that they have paid is their proportionate part of $15,000, which is 15 per cent of the $100,000, on the net profit.

Now, suppose you have a partnership consisting of two persons which also made $100,000 doing the same kind of business. Each partner pays on $50,000, and he has his original tax and his surtax, and the Government gets three times as much out of a partnership as it does out of a corporation.

Dr. Adams. It is just a little worse. I want to add one thing in addition to what you have in mind, that the partnership has not a specific deduction of $2,000. On the other hand, if you should select a corporation earning $25,000 a year instead of $100,000, the situation would have been reserved.

Senator Smoot. And instead of 100 stockholders at $1,000 each, which is not a typical case, because there is not a case of that kind in the country. Suppose you had 20 stockholders.

Senator McCumber. And with $5,000 exemption.

Senator SMOOT. The corporation has no exemption.

Senator SIMMONS. Is it not a proper comparison between a corporation making a given income, say $100,000, as Senator McCumber suggested, and an individual making an income of $100,000, and a corporation with an income of $100,000.

Dr. ADAMS. How many stockholders in your corporation?

Senator SIMMONS. Say three partners in a partnership, and then take some kind of an average number of stockholders for companies making that amount of profit.

Senator CALDER. But, Senator Simmons, when the corporations' profits are divided among individuals they in turn pay tax.

Senator SIMMONS. I understand that. We discussed that a little while ago. Mr. McCoy says 30 per cent of those do not have to pay any income tax at all on the dividend.

Senator CALDER. Because their income is in the exempted class.

Senator SIMMONS. Because their income is in the exempted class.

Senator SMOOT. But 70 per cent pay it.

The CHAIRMAN. What is the committee going to do now? Will we go on with Dr. Adams?

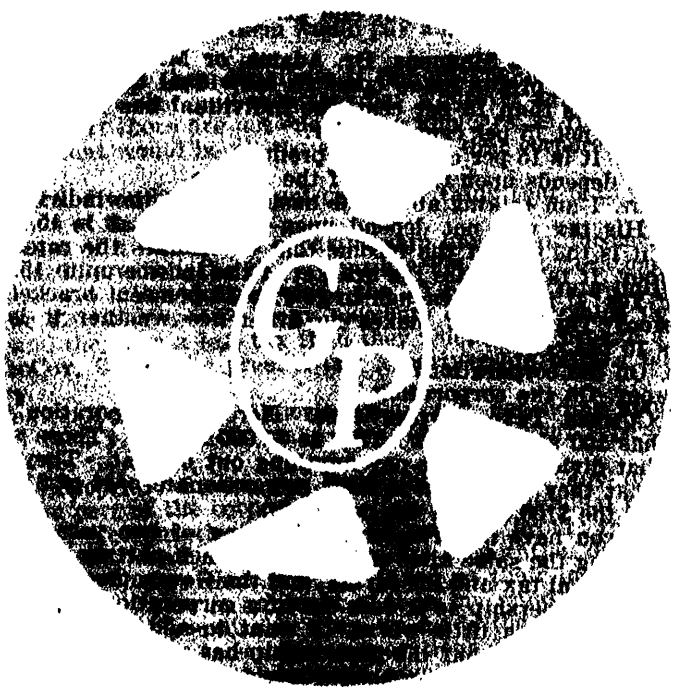
Senator WALSH. I move we adjourn until 10.30 to-morrow morning.

Senator SMOOT. I move an amendment that we adjourn until 3 o'clock this afternoon.

Senator WALSH. I think I should withdraw the motion. I think the responsibility of this is on the majority, and I do not want to be in the position of delaying the proceedings.

The CHAIRMAN. It seems to be the wish of the committee to adjourn until 3 o'clock this afternoon. If that is the pleasure of the committee, we will stand adjourned until that time.

(Thereupon, at 1 o'clock p. m., the committee took a recess until 3 o'clock p. m.)



INTERNAL REVENUE.

SATURDAY, SEPTEMBER 10, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Gerry, and Walsh (Mass.).

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. Let the record show that the committee had been in session for some minutes and that Dr. Adams had been called upon for further explanation of the provision on page 5, line 13, relating to foreign traders, and that Dr. Adams was proceeding as follows:

STATEMENT OF DR. T. S. ADAMS—Resumed.

Dr. ADAMS. The American citizen who is doing business abroad and the domestic corporation which is doing business abroad are now taxed upon the entire net income. Naturally, also, they have the foreign tax to pay as well. We give them credit for the foreign taxes. It is proposed to define this group as foreign traders and foreign-trade corporations and to tax them only on their incomes derived from sources within the United States; that is, to say, to tax them substantially as foreign corporations are now taxed and later to define with particularity so far as possible what constitutes income from sources in the United States.

On page 5 definitions are given of "foreign trader" and "foreign-trade corporations," and in order to be rather certain we kept the percentage high. The thought is that it should apply to individuals and corporations whose business is predominantly done abroad. We adopted 80 per cent. At this point the question still comes up as to the propriety of the selection of 80 per cent rather than 50 per cent.

Senator WALSH. Why wasn't this in the House bill?

Dr. ADAMS. It is in the House bill.

Senator MCCUMBER. Right there comes a question, and that is this: Why can't you say—and what objection would there be to it—that the income tax in this country shall apply only to business done in this country? I appreciate the fact that business may be between two countries and that it may be somewhat difficult, but if they pay one tax to a foreign country on business done in a foreign country, then why pay any proportion of that tax on business done in a foreign country in this country?

Dr. ADAMS. There are three reasons: The first is that I doubt whether Congress would adopt that principle. Of course, that is a matter which is for you to decide.

Secondly, the problem of localizing or allocating income is most difficult, and the taxpayer should not be required to do it unless a large part of the income is earned abroad. I want to keep this requirement within as small a compass as possible. Unless the foreign business constitutes nearly all the business of the corporation, I should not want to do it. When the income from foreign

sources is small, the best solution is to tax all the income and give a credit for income and profits taxes paid to foreign countries. We do that now.

The final reason is with respect to surtaxes in the case of individuals—and I think this is a sound principle—that that tax should be paid to the country of domicile; in other words, where it is received rather than where it is earned. That, however, is a question of theory. I think the surtax—and this seems to be the opinion of students of the subject as well as of a recent international conference dealing with this subject—should be payable at the place of receipt—where you get and spend the money—rather than where you earn it; but with respect to the normal and corporation taxes, they ought to go where the income is earned.

Senator McCUMBER. But you have still to allocate a certain proportion of the earnings abroad and a certain proportion in the United States. You have still to determine that in order to determine whether it is a corporation that is a foreign-trade corporation.

Dr. ADAMS. Not in practice. Ninety nine taxpayers out of a hundred who are receiving income from abroad would know off hand whether it was worth the trouble of going through that process. They would know whether they were near 80 per cent or whether they were way below it. The process of allocating income is so difficult for both the taxpayer and the bureau that it should be avoided as far as possible. Where the income from abroad is small, the credit for foreign taxes solves the problem with sufficient accuracy.

Senator SIMMONS. This says 80 per cent of the gross income.

Dr. ADAMS. I beg your pardon.

Senator SIMMONS. In this paragraph you provided "80 per cent or more of whose gross income for the 3-year period ending with the close of the taxable year"—and so on—"was derived from sources without the United States as determined under section 217."

Then, secondly, you provide "50 per cent or more of whose gross income for such period or such part thereof was derived from the active conduct of a business without the United States either on his own account or as the employee or agent of another."

Senator McCUMBER. The one says "derived from sources without the United States" and the other says "derived from the active conduct of a business without the United States." That seems to be the only difference.

Senator SIMMONS. Does that contemplate two distinct cases, or is one supplementary to the other?

Dr. ADAMS. One is supplementary to the other.

The House did not desire to give this privilege to the mere investor in foreign securities. You see, these European bonds now offer so much inducement to the American investor that we would have taxpayers getting a large part of their incomes from foreign bonds. They did not want to give that privilege to the mere investor, so that they have said that unless the taxpayer gets 50 per cent from the active conduct of business this plan would not apply.

Senator SIMMONS. Eighty per cent must be derived from abroad and 50 per cent must be the result of active conduct of business?

Dr. ADAMS. That is it.

Senator SIMMONS. If he has one, but not the other, he is not a foreign trader?

Dr. ADAMS. Not in the case of the individual.

Senator CURTIS. Which was the proper thing to do.

Senator McCUMBER. Suppose it is 30 per cent from the investment and 20 per cent from the active conduct of business; what is his status?

Dr. ADAMS. He is not in it. He does not get in at all.

Senator SIMMONS. If it were 49 per cent of active business and 79 per cent of income he is not a foreign trader?

Senator McCUMBER. Suppose he has 70 per cent of income from investments abroad and 30 per cent from the active conduct of business?

Dr. ADAMS. He does not get in.

Senator SMOOT. If he had 79 per cent or more and 52 per cent he would not get in under this proposition.

Dr. ADAMS. He has to prove that he is receiving more than half his income from business in order to make him a business man rather than an investor. After he does that he has to show that more than 80 per cent of his income comes from abroad. It is desired, however, to take care of the class of men who are working abroad but who want to keep their American citizenship.

Senator McCUMBER. Suppose he gets 80 per cent on investments abroad?

Senator SMOOT. I have here a notation on my copy to return to the question of personal-service corporations.

Dr. ADAMS. Yes, Senator; that will come in in the next section.

Senator SIMMONS. The man who can qualify as a foreign trader pays no tax upon that part of his income derived from abroad?

Dr. ADAMS. Yes.

Dr. ADAMS. That is correct, and it applies to a corporation similarly.

Senator SIMMONS. And the only tax he pays is a tax upon that part of his income derived here?

Senator SIMMONS. But if he is not a foreign trader, then we tax him both upon his income derived here and abroad and subtract the tax paid abroad from that sum?

Dr. ADAMS. Yes; we subtract only the foreign income and profits tax.

Now, gentlemen, we come to the section dealing with dividends.

The CHAIRMAN. What is the committee going to do?

Senator CURTIS. I move that we agree to the House provision.

The CHAIRMAN. Senator Curtis moves that the committee concur in the provision inserted by the House.

All those in favor of the amendment will say aye. (After a pause.) Those opposed will say no.

It is agreed to and the clerk will make note of the change.

Senator MCCUMBER. To save time, suppose we go on the supposition that it is always agreed to unless some one moves to disagree.

The CHAIRMAN. I will simply ask if there is any objection.

Dr. ADAMS. The first change of importance occurs in lines 12 and 13, page 6. The House struck out the reference to personal service corporations here because they intend that as soon as the excess-profits tax is abolished the personal service corporation shall be treated as any other corporation. That is mainly a question of policy. In that connection, arguments for treating the personal service corporation as other corporations are reenforced by the grave doubt about the constitutionality of the treatment of the persnal service corporation. The personal service corporation is defined as a corporation in which the principal stockholders are actively and personally engaged, and also in which the capital is not a material income-producing factor. That was put in because the excess-profits tax really can not be applied to these corporations. The excess-profits tax rests on capital. Where there is no real capital you can not make it apply. Accordingly, the personal service corporation was taxed as a partnership. If the excess-profits tax should be abolished, they would naturally fall back under the regular treatment of corporations.

As I say, I think this is probably desirable in view of the doubtful constitutionality of the method of treating personal service corporations.

Senators McCumber and Simmons have asked that some method of taxing certain classes of corporations—I do not think it is precisely personal service corporations that they have in mind—be drafted, and we are trying to draft something along that line now. That is a very difficult problem. We will submit the draft later. I think it is not the category of personal service corporations that they have in mind, because the present category of personal service corporations never includes corporations in which capital is an income-producing factor. That is the main question.

Senator SIMMONS. If you abolish the excess-profits tax, what reason could be given for treating the income of personal service corporations differently from the income of any other corporation?

Dr. ADAMS. None, I think.

Senator SIMMONS. Unless you are going to make a distinction between earned and unearned income. It has been, to my mind, a very serious problem for a long time why there should be no distinction between earned and unearned income. I can not see for the life of me why we should tax what a man's brain makes, or measure the tax of a man's brain by the same yardstick that we use to measure the income derived from an investment. I think the tax ought to be higher in one case than in the other. We had that case in my State in the last election, and it was a very much mooted question. We decided in North Carolina that we wanted to tax unearned income more than that earned.

Senator SMOOT. It takes brains to make an income either way.

Senator SIMMONS. In what you call investments it may.

Senator SMOOT. If you do not have brains the investment is soon gone.

Senator GERRY. You tax every widow and orphan more than the man in business.

Senator SIMMONS. I did not mention it for the purpose of starting discussion. I wanted to say merely that if you are not going to make a distinction between earned and unearned income, then I can not see any reason for treating the income of a personal-service corporation different from that of any other corporation.

Dr. ADAMS. If you abolish the excess-profits tax, the tax upon personal-service corporations as partnerships would be rather more strenuous than the tax upon corporations under certain conditions.

The CHAIRMAN. What shall the record show in connection with this personal-service corporation proposition?

Dr. ADAMS. I think that the record should show that the personal-service corporation, upon the repeal of the excess-profits taxes, is to be taxed as other corporations.

The CHAIRMAN. If there is no objection, a memorandum to that effect will be made.

Now go ahead.

Dr. ADAMS. The next question that then comes up is important and has to do with paragraph (b) found on page 7. That provides as follows:

"(b) For the purposes of this act, every distribution is made out of earnings or profits and from the most recently accumulated earnings or profits to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated prior to March 1, 1913, may be distributed exempt from the tax after the earnings and profits accumulated since February 28, 1913, have been distributed."

I think there is no doubt—there has been none in my mind, at least—that earnings accumulated prior to March 1, 1913, should be protected and in a manner be exempted. I am not questioning that. I think, however, there is a real question as to the manner in which it is done. The House provision provides flatly that such earnings may be distributed free of tax. In my opinion they should be treated in this way: Such earnings should be treated as a return on the investment and credited against the investment. For instance, if a man pays $100 for stock and he gets dividends from earnings accumulated before March 1, 1913, they should be treated as a return of his cost or as a return of the March 1, 1913, value of his stock, if acquired before that date, for the reason that the cost on the March 1 value is dependent upon the corporate surplus existing at that time. If, therefore, the surplus or accumulated profits existing at that time is distributed, the stockholder's cost on March 1, 1913, value basis should be correspondingly reduced.

Under the present law and under the House provision nothing is said about that. It is provided simply that they go free of taxation. But if the taxpayer's cost basis or March 1, 1913, valuation is retained intact, I should think that a grave injustice would be done. Let me illustrate: Suppose a man invested $100 in the stock of a corporation in 1905. By March 1, 1913, the corporation has accumulated a surplus equal to its original capital. Let us suppose the stock is now worth $200. Thereafter, on any sale of that stock he gets a deduction for $200. That is the value on March 1, 1913. Suppose that corporation then distributes that surplus which gave the stock its value of $200, or half of its value. He takes that under the present law tax free.

Senator MCCUMBER. That is capital.

Dr. ADAMS. That is all right. What I want to do is to provide that his value basis of March 1, 1913, shall come down. If you do not do it you will get into a difficult position. I ought to call attention here to the fact that the chairman of the Ways and Means Committee and myself had a difference of opinion on this question. He feels deeply about the matter, and it should have specially careful consideration on that account. I felt at the time that the chairman misunderstood what I was trying to do. I think the original Treasury recommendation was right, and while doing no injustice served to protect against possible abuse.

Senator SMOOT. Let us go into that a little further. Suppose that it was worth $200 on March 1, 1913, and that it ran on for five years more and was worth then $300. Now, they make a distribution of $100. Would you still hold that that would be just $100?

Dr. ADAMS. Any distribution of profits earned after March 1, 1913, would be taxable.

Senator SMOOT. You would tax that now?

Dr. ADAMS. And always have. Those are earnings that would be taxed as dividends.

Senator SMOOT. That would not be taken at all from $200?

Dr. ADAMS. Oh, no; that would not affect it one way or the other.

Senator SMOOT. But the law to-day says it must be out of the most recently accumulated profits.

Dr. ADAMS. You have to distribute backward.

Senator SMOOT. This does not change that?

Dr. ADAMS. No.

Senator CURTIS. What is your amendment?

Dr. ADAMS. I will read the amendment to you. The amendment would, in substance, begin at line 10, at 1913, where you say "but any." But I will read all of paragraphs (b) and (c).

"(b) For the purposes of this act every distribution, except on a bona fide liquidation of the corporation, is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913.

"(c) Any distribution (whether in cash or other property) made by a corporation to its shareholders or members (1) otherwise than out of earnings or profits accumulated since February 28, 1913, or (2) on a bona fide liquidation of the corporation, shall be treated as a partial or full return of the cost to the distributee of his stock or shares. Any gain or loss realized from such distribution or from the sale or other disposition of such stock or shares shall be treated in the same manner as other gains or losses under the provisions of section 202."

This changes the rule with respect to dividends from profits accumulated prior to March 1, 1923. They are untaxed until the stockholder gets his cost or March 1, 1913, value back, but they are treated as "other distributions." In other words, you count these other distributions against cost. Thereafter he would be subject to a tax on any return above cost, or March 1 value.

Senator MCCUMBER. Suppose that the assets of the corporation are worth $1,000,000 on March 1, 1913. That is the basis you take to determine their profits that have been made since that date?

Dr. ADAMS. No. That is a slightly different thing. The profits are what the books show have been earned, if the books have been properly kept.

Senator MCCUMBER. But whether it was over 8 per cent or not, you have got to have as a basis what the investment is.

Dr. ADAMS. That is not involved here, Senator. That relates to the excess-profits tax. The provisions relating to invested capital are not involved here. This is a question of dividends and of gains or losses on the sale of stock. This question arises whether you have the excess-profit tax or not.

Senator MCCUMBER. This is intended to deal only with sales.

Dr. ADAMS. Gains or losses. It is dealing with dividends primarily.

Senator MCCUMBER. It has to do with dividends, and dividends must be earnings, and earnings must be based on something.

Dr. ADAMS. Yes; that is true; but I wanted to avoid the complexities of invested capital for purposes of the excess-profits tax.

Senator MCCUMBER. The point I had in mind was this, that in estimating what the corporation makes, whether it is a profit or a loss, it is made on the assumption, in our law, that everything that the corporation had up to March 1, 1913—its surplus, its undivided profits, etc.—is part of its assets and part of its investment; therefore, if they divide that or any portion of that, it necessarily reduces the capital investment.

Dr. ADAMS. Let us take an illustration.

Senator MCCUMBER. And the next year they would divide 50 per cent of what they earned prior to February 28, 1913, of their surplus, we will say, and the surplus was 50 per cent. We would then go back to the original and that would be the capital invested.

Dr. ADAMS. May I answer that by way of illustration?

Senator MCCUMBER. Yes.

Dr. ADAMS. Let us take a corporation that started any time before 1913, with $1,000,000 capital. Let us assume that up to March 1, 1913, it had accumulated a $1,000,000 surplus. Their stock would possibly be selling $200 on March 1, 1913, dependent upon the dividend rate and expectations for the future.

Senator MCCUMBER. And their assets at that time would be $2,000,000?

Dr. ADAMS. Their assets at that time would $2,000,000. Let us suppose now that the corporation became prosperous and in 1921 began to distribute surplus. Now, it will distribute, first of all, the surplus earned after March 1,

1913. That will be taxable. Then it goes back to the surplus earned before March 1, 1913. The House bill provides that it may be distributed tax free. That is all right if done in the proper manner. I want to see that at that point any further distribution of the surplus shall count against the taxpayers' investment in the property.

Senator McCUMBER. That is my point.

Dr. ADAMS. By provision of law the taxpayer is entitled to use the March 1, 1913, value as a basis for determining gain or loss on sale. If you distribute surplus earned prior to March 1, 1913, tax free, saying nothing about the basis, he gets the surplus and gets back $200 tax free if he sells his stock.

Senator SMOOT. It does seem to me that if he kept books correctly that would show on the books. He would not have $2,000,000 if he distributed it.

Dr. ADAMS. But the law relating to the sale says that in case he sells again he can claim $200 as the basis on which to compute the gain. There is another point. We have a great many kinds of distributions to look after—distributions from depletion reserves, partial liquidations of all kinds. That is not properly covered in the House provision, or in the provision of the present law. The new phraseology is general. The rule, it seems to me, is a fair one and a just one. I am sure that you will wish to take care of all these other distributions.

Senator SIMMONS. Don't the books of the corporation show what the earnings were before March, 1913?

Dr. ADAMS. They usually do, sir.

Senator SIMMONS. Then, that part of the earnings ought to be taxed. Suppose you made certain earnings up to March 1, 1913. Those earnings have not been taxed, but on March 1, 1913, there is a certain amount of capital. It may be that was made up of original investment and accumulated surplus.

Dr. ADAMS. Are you talking about corporations?

Senator SIMMONS. Yes.

Senator McCUMBER. It must be, not merely "may be."

Senator SIMMONS. He starts out on March 1, 1913, with new capital. We are entitled to tax that income raised from the new capital, however it may have been earned, whether it was put up or earned.

Dr. ADAMS. Suppose a man owns stock in a corporation for which he paid $100, in 1905. Suppose the corporation earns as much surplus by 1913 as it had original capital. Then later it comes to distributing that surplus.

Senator CURTIS. Cover his case. Take the next step on that end.

Dr. ADAMS. I am not following you, Senator Curtis.

Senator CURTIS. He raised the question as to the income on the double capital, that is, the capital and the surplus which was taxable. That is the end of the question. You did not cover that in your illustration. I claim that on that income taxes are paid until sold.

Dr. ADAMS. You mean the earnings on the income?

Senator SIMMONS. When you get to that stock in 1913, if he wanted to, he could withdraw all accumulated surplus out of the business, but if he does not withdraw it from the business and it remains in the business, then that is so much new capital with which he starts to do business in 1913.

Senator CURTIS. And the profit made on that pays a tax until he sells it.

Now, then, when he sells it, or when he gets his distribution—when the stock is sold first, it goes back, if there has been no distribution, to the original value, but if there has been distribution it goes back to the value of 1913 because it has dropped one half.

Dr. ADAMS. I want to take into account that drop in the value due to the distribution of something upon which that value was based.

Senator McCUMBER. What is the amendment?

Dr. ADAMS. The amendment is to insert——

Senator SMOOT (interposing). There is another point to make, and that is the way the thing will work out in a business way. Let us take this as an illustration. Here is a business with $1,000,000 in 1890. They have a million surplus by March 1, 1913. The corporation was organized, we will say, in 1890 with $1,000,000 and during the period 1890 to 1913 accumulated a surplus of $1,000,000 by March 1. They start here with $2,000,000 assets, the books showing that. Now, if they want to distribute any part of this $2,000,000, they can distribute $1,000,000 of it tax free. Then there is left on the books only $1,000,000, and they can take their allowances, 8 per cent or whatever they may be, only on that $1,000,000 and not on the $2,000,000, under existing law.

Dr. ADAMS. I had been talking not about the excess-profits tax and the corporation, but about the stockholder. Let us suppose that the stockholder in 1921 wants to sell at a gain. What value does he have to compute his profit on? He has the value of March 1, 1913, unqualified.

Senator SMOOT. Provided there has been no distribution made.

Dr. ADAMS. But you do not say that in the law. That is the point.

Senator SMOOT. They will tax you that way.

Dr. ADAMS. That is a question of doubt, but certainly in the case of stock bought after March 1, 1913, there is no doubt.

Senator CURTIS. Let me give a personal case.

(Informal discussion followed which the reporter was directed, not to record.)

Dr. ADAMS. In order that it may not be in grave doubt, we want to put something in here to make it clear. The question is whether the March 1, 1913, valuation of the stock under existing law is made as of the condition existing at that time or as of the condition existing after the surplus of a million dollars has been distributeed. The law says the value of the stock as of March 1, 1913. It does not say the value of the stock as of March, 1913, must take into account distributions made several years later. That is the whole point.

Senator SMOOT. The books would show the whole thing.

Senator MCCUMBER. It is not a question of what the books show; it is a question of what the law says. The law says that for the purpose of determining profits you take the value of that stock on March 1, 1913.

Dr. ADAMS. Of course, Senator Smoot, the equitable way is as you say. We should reduce the value of the stock in proper proportion. If you will read the law I think you will say there is a doubt about that. The law reads:

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be:

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date."

What was the value of it as of that date? You have the $1,000,000 surplus on March 1, 1913, but you don't distribute it until 1920, seven years later.

Senator SMOOT. But, Dr. Adams, after you sell a part on the value as of March 1, 1913, and are required to make the value as of that date, of course, it is a deduction, and it would have to be shown upon the books.

Dr. ADAMS. I understand Senator Smoot to say what I have been trying to say, that when a stockholder gets a distribution of this kind he ought to credit it against his cost and correspondingly reduce his cost.

Senator SMOOT. He does not have to pay a tax on $1,000,000.

Dr. ADAMS. Not at all, and should not.

Senator SMOOT. But when he pays his tax hereafter, if there is any gain above the $1,000,000, he has to pay every dollar of it. After that you would not allow a deduction of 8 per cent, or whatever it may be, on his capital stock or surplus, because it would only be $1,000,000, instead of $2,000,000.

Dr. ADAMS. That point is not involved in the question of one whose stock sells at a gain or loss. If a man owns a block of stock, and under existing law gets back the March 1, 1913, surplus on which its value is partly based, he would not be required to write down the cost value of his stock on his own books at all, under the present law or the proposed House law. All I am asking to be done is to charge that against the cost.

Senator SMOOT. If anybody does not do it now, it seems to me perfectly absurd.

Dr. ADAMS. It is tax free, without any further account of it.

The CHAIRMAN. If there are no objections, the amendment as suggested by Dr. Adams will be approved by the committee.

Senator LA FOLLETTE. Will you read the amendment, Dr. Adams?

Dr. ADAMS. That amendment would be as follows: I want to give it all to you and make it as clear as I can. After the word "distribution" in line 7, insert a comma, and add the words "except on a bona fide liquidation of the corporation." It would then read:

"For the purposes of this act every distribution, except on a bona fide liquidation of the corporation, is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913."

Then strike out the semicolon and insert a period. Then strike out everything after that period to the end of the subdivision, to the end of line 14, and insert in lieu thereof the following:

"Any distributions (whether in cash or other property) made by a corporation to its shareholders or members (1) otherwise than out of earnings or profits accumulated since Ferbuary 28, 1913;"

Any distribution, except out of profits or earnings which have accumulated since February 28, 1913.

Senator McCUMBER. For the sake of brevity, I would suggest that you rewrite that section, strike it all out after the place you have indicated and rewrite it.

Dr. ADAMS. I shall do that, of course, Senator McCumber.

"or (2) on a bona fide liquidation of the corporation, shall be treated as a partial or full return of the cost to the distributee of his stock or shares. Any gain or loss realized from such distribution or from the sale or other disposition of such stock or shares shall be treated in the same manner as other gains or losses under the provisions of section 202."

Now, I have no other change in that section to suggest, and do not recall that there is anything else in this dividend section that is questioned.

Senator LA FOLLETTE. I have noted on the margin "return to section (c)."

Dr. ADAMS. That was the section that we had. "A dividend paid in stock of the corporation shall be considered income to the amount of earnings or profits distributed. Amounts distributed in the liquidation of a corporation shall be treated as in part or in full payment in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits."

The first part of that is invalidated by the stock-dividend decision; the last part is substantially incorporated in what I just read.

Senator SIMMONS. Doctor, do you strike out all after the word "but" in line 10?

Dr. ADAMS. Excuse me. I made a mistake about that.

"Amounts distributed in the liquidation of a corporation shall be treated as in part or in full payment in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributes as other gains or profits."

The substance of that stays in, lines 17 to 21, page 7.

Senator SMOOT. That ought to stay in.

Dr. ADAMS. That ought to stay in.

Now, on page 10, section 202, you come to what many people consider the most important section in the law.

Senator DILLINGHAM. Have you disposed of that amendment on page 8?

Dr. ADAMS. That amendment states when a dividend shall be taxed.

Senator DILLINGHAM. I remember that, but I did not know whether we had acted on it or not.

The CHAIRMAN. The committee should act on all these amendments.

Senator SIMMONS. I understand we are to take up all the amendments

The CHAIRMAN. We should make at least a perfunctory indorsement of unobjected amendments.

Dr. ADAMS. That amendment on page 8 is to fix a particular date or time as of which a dividend is taxable; and it fixes the time when the distribution becomes unqualifiedly subject to the demand of the taxpayer. We are enforcing the law that way.

Senator DILLINGHAM. I move its adoption.

Senator SIMMONS. "(d)" on page 8 is substituted for "(d)" on page 7 in the House.

Senator SMOOT. I think it is unconstitutional.

Dr. ADAMS. That is a section that is obsolete and has no meaning now. It provided—

"If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of 30 days after the passage of this act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits."

The CHAIRMAN. The amendment on page 8 is agreed to if there are no objections.

Dr. ADAMS. Subdivision (d) on page 8 is a new provision relating to the time of taxing the dividends. That is a real problem, gentlemen, and should have careful consideration. The suggestion is to tax the dividend when it becomes available to the stockholder.

The CHAIRMAN. It ought to be when he gets it into his possession.

Dr. ADAMS. At differing times in the case of different stockholders?

Senator SMOOT. Yes.

Dr. ADAMS. There is a good deal to be said on that.

Senator MCCUMBER. Suppose it is made on the 31st of December, and he does not get his check on it. The dividend is declared, and he can get it. It is under his control at that time.

Dr. ADAMS. A corporation declares a dividend payable December 27. It starts to write checks on December 27 and sends them out. Some get them on the 28th, and some on the 29th, and stockholders who live in California may not get their checks until January 2. Should we tax the man who gets it on January 2 in San Francisco at a different rate from the man who gets it on December 29?

Senator SUTHERLAND. Some may be abroad.

Dr. ADAMS. Some may not go to their mail box and take it out. We are using a uniform date as the date when they become legally taxable.

The CHAIRMAN. That amendment is agreed to. Proceed, Dr. Adams.

Dr. ADAMS. Page 10, line 9, section 202. That provides a new and complicated rule for determining the gain or loss on property which has been caused or necessitated by the decision of the Supreme Court recently in the Goodrich case, so called. It provides that:

"(a) The basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

"(1) In the case of such property which should be included in the inventory the basis shall be the last inventory value thereof."

That is the present law. Do you want to confirm this, paragraph by paragraph, as we go along?

The CHAIRMAN. I do not think so.

Dr. ADAMS. "(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be 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."

Senator SMOOT. That is questionable, is it not, under the Constitution?

Dr. ADAMS. I do not think it is questionable under the Constitution, but it is a grave question of policy.

"If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof."

The rest is administrative. The point is that in case of a gift——

Senator WATSON (interposing). Which is not now taxable.

Dr. ADAMS (continuing). Which is not now taxable, is not under the law taxable, the question is as to the value or basis which it takes in the hands of the donee. At the present time the donee takes the market value of the property at the time received as a basis, and if there has been an appreciation since the donor originally acquired it that goes untaxed, when the donor sells.

Take an illustration. Suppose a man bought stock in 1915 at 100. Suppose it comes to be worth 200 in 1921. He gives it to his daughter. The question is, Shall that have a value of 200 or 100 in the hands of the daughter? At the present time it has a value of 200, although the owner paid 100. If the daughter sells at 150, she may take a loss of 50. The proposed provision provides that the basis shall be the cost to the donor, and it would be 100 in that case. There is no tax until the donee sells or realizes a gain or loss, but the amount is computed as against the cost or other basis to the original donor.

Senator MCCUMBER. Why? It seems to me the only ground would be that you can possibly get more tax, but where is the equity in it?

Dr. ADAMS. Do you want that appreciation in the hands of the donor to go untaxed?

Senator MCCUMBER. Suppose I give something to a member of my family that is worth $2,000 to-day, even though it was only worth $1,000 five years ago, or may have been worth $10,000. I give my child $2,000, just the same as if it had acquired it in some other way. It belongs to the child. If the child

wants to dispose of it, why should you go back and take into consideration the increase in its value since the parent got it five or six years before that? Why should that be charged to the child?

Dr. ADAMS. Suppose I buy stock in 1915 for $100, and by no virtue of my own, but by a mere change in the market, it rises in value until it becomes worth $200 in 1922. I give it to my daughter. I give her the $100, which I paid for it, and $100 unrealized profit arising from a fortunate investment. The latter $100, under existing law, if sold or realized by sale, would not be taxed.

What I object to is that by reason of this gift provision there escapes an increment which is to my mind a particularly proper source of taxation when realized. I object still more to the claimed losses in this connection, based upon the value at the time of gift.

Senator MCCUMBER. Suppose I have a son and daughter. I give the daughter some stock and give the son real estate. Both the stock and real estate may advance in value in the same proportion. Both sell their property of the same value on the date they receive it. Then you say to the daughter, "If you sell yours, you will have to go back four or five years and find out what it was worth then, and you will have to account for 100 per cent profits." To the son, if he sells his, although the expectation was they were dividing even at that time, you will say, "You are to have just such a profit as you made after you received it, on the basis of what it was when you received it."

Dr. ADAMS. The real estate is just like the stock.

Senator MCCUMBER. Suppose the real estate costs the father $10,000, and five years afterward he gives it to his son and it has not advanced a cent. Suppose he had something else that was worth $5,000 five years before that time, and he gives it to his daughter, and it is worth $10,000. The son sells his for $11,000, and the daughter sells hers for $11,000. You say to the son, "You made $1,000, and that is all the profit you can make on that." But you claim the daughter has made $6,000. It seems to me our struggle to get the greatest possible amount of tax ought not to go to the extent of making fictitious values in the hands of the donee.

The CHAIRMAN. Dr. Adams, is there a very large amount of revenue involved in that proposition?

Dr. ADAMS. It is one of the principal sources of evasion or avoidance at the present time. As to the questions of ethics, I do not know that my opinion is worth as much as Senator McCumber's.

Senator MCCUMBER. It may be worth a great deal more.

Dr. ADAMS. I do not think that. Most men who contemplate giving property away, will, other considerations being equal, give away property which has enhanced in value, and consequently gains will escape taxation; but they will hold or actually sell the property which has diminished in value, and then take their losses.

Senator MCCUMBER. It seems to me it would be better to provide that if it is gift property there can be no gains or losses.

Dr. ADAMS. That is a good suggestion. If you do not accept this, I hope you will do that.

Senator SIMMONS. Suppose I own a piece of property that has enhanced in value 50 per cent since 1913. I could give that to one of my children, provided I had an opportunity to sell it, but if I sold it myself I would have to account for that 50 per cent advance in value.

Dr. ADAMS. Yes.

Senator SIMMONS. If I gave it to one of my children and that child sells it the next day, she would not have to account for it.

Dr. ADAMS. No.

Senator SIMMONS. And that is what you want to avoid?

Dr. ADAMS. Yes.

Senator SIMMONS. And you say if we do not provide for that it is an inducement to every man that wants to evade the law, when he wants to make a sale, to first make a gift?

Dr. ADAMS. Yes.

Senator SIMMONS. And then let the donee make the sale?

Dr. ADAMS. Yes.

Senator SIMMONS. It seems to me if that is the effect of it, that would open the door to very grave abuses.

Senator SMOOT. It seems to me there is a constitutional question involved in this, as I stated before. The constitutional question which appears to me is as

to the power to tax a person on income gained or profit made where no gain has occurred to the individual. You are trying to tax the individual for a gain that is held by the father, in case it was the father, and on which the father had been compelled to pay taxes right along until he transferred it.

Dr. ADAMS. The father has not paid taxes on the accrued profit.

Senator SMOOT. He paid taxes on whatever income there was from that property.

Dr. ADAMS. He has not paid on the capital increase.

Senator SMOOT. He paid on whatever was made out of it. I think under the ruling of the Supreme Court that would be held unconstitutional for the reason that you can not tax an income to a person that never has had any benefit from it, that never accrued during the time the person held it.

Senator WALSH. Why should that not be taxed as income?

Dr. ADAMS. It is purely a question of policy for you gentlemen to decide.

Senator WALSH. Why should that not be a source of revenue, where they get something for nothing?

Dr. ADAMS. The income tax of 1894 treated gifts as income. The Wisconsin income tax of 1911 treated gifts as income. That is one method of disposing of it.

There is another method of taxing gifts. They could be taxed under the inheritance tax laws. That question will unquestionably arise in the future.

Senator SIMMONS. If we can deal with it in that way, ought we not make the donor pay it, if there is an increase?

Dr. ADAMS. I do not think that the donor can be taxed. But I believe that the donee may be taxed when he sells the property acquired by gift.

Senator SIMMONS. I think that is the proper and most merciful way.

Dr. ADAMS That is what I thought.

Senator WALSH. I think there should be some provision that a donee should be charged for a term of years the tax which the donor would have had to pay if he had not made the gift.

Dr. ADAMS. He would not have to pay any tax unless he sold it.

Senator WALSH. We should stop these evasions. Could a provision be made compelling the donee to pay upon that gift the rate of taxation which the donor would have had to pay for a period of five years if he had not made the gift?

Dr. ADAMS. Senator Walsh, the donor would not pay any tax unless he sold.

Senator WALSH. He gives it away and thus evades the tax.

Dr. ADAMS. I do not quite get your point. Would this be your point: The donor gives property to somebody which is worth $200 but cost him $100, and that should be treated as a gain of $100 and should be taxed to the donee over a period of years?

Senator WALSH. No. I am not speaking of an outright gift. If a party is giving something to a child to reduce his income tax, should we not have a provision in this bill providing that he must pay that difference, so that the whole amount will be paid?

Dr. ADAMS. I do not want to stop gifts, because I think they are good; but I want somebody to pay a tax on a realized increment of value that otherwise would not be taxed.

Senator WALSH. I approve of that. I understood you to say gifts are one of the favorite methods of evading the tax.

Dr. ADAMS. Yes; but suppose they do it in good faith. I do not want to stop that.

Senator SIMMONS. As I understand this proposition, if a gift is made and the donee afterwards sells the property, in ascertaining its original cost you go back to its acquisition by the donor.

Dr. ADAMS. Take whatever basis he would have.

Senator SIMMONS. I think that is a correct principle.

Senator CURTIS. Dr. Adams, did you have an amendment to that?

Dr. ADAMS. No; I have no amendment to the gift provision.

Senator WALSH. Mr. Chairman, I move an amendment that the donee shall not be permitted to take a loss.

Senator MCCUMBER. The question is on the House proposition and the amendment of Senator Walsh in paragraph 2. Those in favor signify the same by raising their hands; opposed the same. It is carried.

I think it is so serious that it can be regarded only as tentative, because I do not believe it ought to be done.

Does that take in just subdivision 2?

Dr. ADAMS. That takes only 2. There is no change in subdivision 3 from the present law. It is practically the present law.

"In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in subdivison (c) or (e) of section 402."

Senator WATSON. What are they?

Dr. ADAMS. Gifts in contemplation of death or to take effect in possession and enjoyment at or after death. Where it is acquired in that way it is subject to estate tax, and I think it is entirely fair and proper That is the reason we give the value at the time of acquisition. Prpoerty acquired by bequest, devise, or inheritance is subject to the estate tax .

Senator MCCUMBER. If there are no objections, it will be agreed to.

Dr. ADAMS. Subdivision (b):

"The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a)."

It is here where the involved rule recently approved by the Supreme Court comes in. That rule is in substance that where property is increasing in value, rising steadily from the time of acquisition until the time it is sold, the March 1, 1913, valuation is used or employed. That is in substance the present law. If you sell property at a gain and that property has been rising steadily in value from the time of acquisition until the time sold, you are taxed on the difference between the March 1, 1913, valuation and the price received. The same rule applies in the case of property that is steadily decreasing in value from the time it is acquired until sold. For instance, if you acquired property in 1905 at $100 and it was worth $70 on March 1, 1913, and sold in 1921 at $30, there is a loss of $40. In such case you take the difference between the March 1, 1913, value and the selling price as the loss which you may claim.

Now, if you have an intermediate case, where property goes down in value between the time of acquisition and March 1, 1913, and then goes up beyond the original cost, you would tax the difference between the original cost and the selling price. That is a new proposition. Where the value of the property goes up between the date of acquisition and March 1, 1913, and then comes down, or comes down between date of acquisition and March 1, 1913, and then goes up, you do not recognize any of those fluctuations between the acquisition date and March 1, 1913, but compute the gain or loss against the original cost.

Senator CURTIS. We eliminate the fluctuations.

Dr. ADAMS. We eliminate the fluctuations. It is a complex rule. I wish we didn't have to do it, but apparently we must under the ruling of the court.

Senator GERRY. What was the case in which that decision was rendered?

Dr. ADAMS. Goodrich *v.* Edwards and Brewster *v.* Walsh.

Senator CURTIS. Mr. Chairman, Dr. Adams explained that the other day, and the only question was as to the gift. I suggest we adopt it now.

Dr. ADAMS. You are down to (d). I think you do not want to take (d) without some discussion.

Senator SMOOT. In subdivision (c), on page 12, it reads as follows:

"In ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, proper adjustment shall be made."

What is a "proper adjustment"?

Dr. ADAMS. There are hundreds of them.

Senator SMOOT. I should think there would be. I do not see how you are going to determine it.

Dr. ADAMS. We are doing it every day. That is the present rule.

Senator MCCUMBER. Suppose I have real estate and erect buildings on it which add to its value. You have to make a proper adjustment.

Dr. ADAMS. You can strike that out if you you want to.

Senator LA FOLLETTE. You have to do it now.

Dr. ADAMS. We have to do it now. I am willing to have it stricken out if you want to.

Is (c) approved without objection, lines 6 to 12, page 12?

Senator MCCUMBER. Are there any objections? It is agreed to without objection.

Dr. ADAMS. I understand that (b) is approved.

Senator MCCUMBER. Yes. How about (d)?

Dr. ADAMS. I think we should go over that. That is probably one of the most important subdivisions in the law.

"For the purposes of this title, on an exchange of property, real, personal, or mixed, or any other such property, no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value."

That is given as a general rule in exchanges. That has been widely discussed, and when we went over it before there was some question about the use of those words "definite and."

Senator SMOOT. I think it is very doubtful indeed.

Dr. ADAMS. This deals with exchanges and so-called trades. A man exchanges property for property. Under existing law, if the property received has a market value we proceed to value it and tax the gain as against that valuation or recognize the loss. We know what the property disposed of cost him. He bought it for something, and we can find that out. But it is different when you come to the property he receives in exchange.

We tax all sorts of trades at the present time. The presumption is in favor of taxability, and unless the taxpayer can prove the property received in exchange has no market value we compute a gain or loss. It is a difficult rule.

Senator LA FOLLETTE. What do you take as the value of the property received in exchange?

Dr. ADAMS. The market value at the time he gets it.

Senator CURTIS. Why not strike out those words "definite and"?

Dr. ADAMS. Valuation is always to be avoided if possible. There is a wide latitude for difference of opinion, and the department is alternately criticized for making the values too high or too low. The sound rule is, no tax unless you can find a definite market value which is readily realizable. The situation is spotted now, and there is not unlikely to be in the future more losses than gains. From the standpoint of the Treasury Department, that is perhaps more important than the possible gains accruing from exchanges.

Now, then, do you want to have a presumption that the law shall apply only in exchanges such as of Liberty bonds, where there is a definite market value, or do you want us to try to value any property that is exchanged? The suggested language given here registers the official recommendation of the Treasury Department, made after much care and thought.

Senator SMOOT. Doctor, take the situation existing in Utah to-day. I think I can speak for every other State, but I will speak for Utah, because I know the conditions there. This provides that you shall have a definite and readily realizable market value. I can go into the State of Utah to-day, and if I were to have a farm for sale——

Dr. ADAMS. To exchange?

Senator SMOOT. Well, to exchange—I do not know what I could get for it.

Dr. ADAMS. That is the point. Should it be taxable?

Senator SMOOT. I think so, because the value is there.

Dr. ADAMS. What is it?

Senator SMOOT. The value the State or county places upon it for taxation purposes.

Dr. ADAMS. That is just the whole point. Do you want us to try to get a tax in case of these trades, particularly when the trades involve difficult valuations which may be wrong and take a good deal of trouble and time?

Senator SMOOT. According to the language here it must have a readily realizable market value.

Dr. ADAMS. Yes. Ought you to tax the taxpayer if it does not have a readily realizable market value?

Senator GERRY. Would it not cost the Government more to collect that money than you would get in the way of revenue?

Dr. ADAMS. I have no doubt about the expediency of doing what is suggested here. It is a question of where you are going to stop. Take Senator Smoot's proposition. Suppose a man in Utah has a very valuable ranch and he trades it for some mining stock, some real mining stock. Just what that stock is worth and how much its sale will depress the market are uncertain things. The ranch owner exchanges his ranch for this stock. He has something which has no definite value. He can not realize on it. Is that a time to impose a tax? Is that not what everybody is kicking against?

Senator WATSON. I do not see how you are going to get it.

Dr. ADAMS. The new rule would be easily administered. We would not have anything to do.

Senator SMOOT. If you can find the definite and readily realizable market value of mining stock to-day, I would like to have you do it.

Dr. ADAMS. You do not have to do anything unless it is definite. It is an easy proposition. That is the whole point.

If we strike out the words "definite and readily realizable" we have to go on and impose the tax each time.

The CHAIRMAN. Is that what you are doing in the department now?

Dr. ADAMS. No; the proposed rule is very different from what we are doing.

Senator CALDER. I sold a piece of property for $120,000 that cost me $95,000. I took in part payment another piece of vacant land, put in the trade at $20,000, and received the difference in cash. How about that transaction?

Dr. ADAMS. That will be treated later. I have an amendment to cover that. It is not mentioned here.

Senator CALDER. I would have to pay tax on the transaction.

Dr. ADAMS. You would have to pay a tax under the existing law if you got vacant property for part of it and cash for the balance.

Senator CALDER. Does not this relieve me of that?

Dr. ADAMS. To a large extent it does; yes.

Senator SIMMONS. Doctor, where parties to a transaction made a straight exchange of property, one giving his property for the other's property, I think we can trust ordinarily to the judgment of those two people as to the value of their property. They both value it according to their own judgment, and their interest is sufficient to guarantee that the values are reasonably fair. But in a case like the Senator from New York stated, where there is a difference paid, is not your language broad enough to cover that case, as well as a case where the exchange is even, and would there be any tax in case of an exchange where there was a difference and the difference was paid in cash? If it means that, it opens the door wide to frauds against the revenue.

Dr. ADAMS. Where is the fraud against the revenue, Senator?

Senator SIMMONS. If I want to sell a piece of property, and I find that if I sell it I will have a profit on its value in 1913 of $10,000; I want to avoid paying that tax, and I say to the man that wants to buy, "Let us make an exchange. You give me a little piece of property of insignificant value in part payment and pay me the difference in cash." Would I not escape the tax altogether?

Dr. ADAMS. You would not escape it at all if the property had a definite and readily realizable market value, but in order to cover your case I will suggest at the appropriate time, when we come to it, this amendment.

"But where property is exchanged for other property having no readily realizable market value and money, or for such property and property which has a readily realizable market value, the money or property having such readily realizable market value shall be treated as a partial or full return of the cost on such basis as is used in this section for the purpose of ascertaining the gains derived or losses sutained from the sale of such property. Any gains or losses realized in such exchanges shall be treated in the same manner as other gains or losses."

In other words, they shall be taxed.

Senator SIMMONS. I think you should eliminate "definite and readily realizable market value" from a case of that kind and ascertain it in the best method you can.

Senator WATSON. That would leave nothing in the section.

Senator MCLEAN. I think you would better keep the word "definite."

Senator SMOOT. Read your proposed amendment. I thought you gave it differently from that.

Dr. ADAMS. I did, but the amendment now proposed only mentions "readily realizable." It does not mention "definite."

The CHAIRMAN. If there are no objections, the amendment will be agreed to. Proceed, Doctor.

Dr. ADAMS. These paragraphs you will recall are cases where no gain or loss is recognized, even though the property received in exchange has a definite and readily realizable market value. A man may receive readily realizable property in exchange, but even though he does, in these cases no gains or losses would be recognized. I have been asked to call special attention to subdivision 1. It should be considered carefully before it is passed on.

"When any such property held for investment or for productive use in trade or business (not including stock in trade or other property held primarily for sale) is exchanged for property of a like kind or use."

The only question I have is where securities are exchanged. Attention has been called to the fact that a man may hold United States Steel stock, and he may exchange it for stock in the Pennsylvania Railroad Co., and I have doubt as to whether or not we ought to recognize the gains or losses. I want you to pass on that rather than myself. The part which has been questioned is "When any such property held for investment." I think the productive use in business part is unquestionable. But objection has been made that the investment part would encourage trades to register losses, although this seems to me its strong point.

Senator WATSON. How?

Dr. ADAMS. I have two friends who last year owned various blocks of Liberty bonds, and they traded bonds. They were of different denominations, and each of them took a loss. I don't know what one claimed, but I know the other claimed a $14,000 loss. Do you want to recognize that kind of a transaction? If you cut out the losses, you should cut out the gains.

Senator WATSON. They could do that the same under existing law.

Dr. ADAMS. They could. That is why a change in the law is recommended.

Senator MCLEAN. In a provision later on do you not provide against the repurchase of different stock?

Dr. ADAMS. No; only identical securities. I am not certain that provision later on is going to be very effective. You will have a real control in the words "readily realizable." That is the proper principle. I am of the opinion you will not have to touch exchange of securities at all, except on the proposition of exchanging direct to realize loss.

Senator MCLEAN. Would not the value be estimated?

Dr. ADAMS. This exempts any gain even though it is readily realizable.

Senator CURTIS. I do not think they should be allowed the loss.

Dr. ADAMS. I do not think we want to debar the losses and recognize the gains.

Senator LA FOLLETTE. What would you strike out?

Dr. ADAMS. "When any such property held for investment," leaving in "or for productive use," etc.

Senator LA FOLLETTE. Strike out "for investment or."

Dr. ADAMS. Yes. I don't recommend it. I want you to see it and to get your judgment. I am in very grave doubt as to what should be done.

Senator LA FOLLETTE. But you know it opens the door for some abuses.

Dr. ADAMS. It opens the door for trades of securities where gains could be realized without taxing them. It also closes the door to realizing losses, which is more important.

The CHAIRMAN. I think whatever will make the bill least complicated and less calculated to drive people to insanity is the thing to do.

Senator SMOOT. I move we disapprove of No. 1.

The CHAIRMAN. In the interest of simplicity, Senator Smoot moves that the committee disapprove of No. 1.

Senator MCLEAN. They can not take advantage for the purpose of estimating losses on exchanges of that kind if this goes in.

Dr. ADAMS. No; they can not.

Senator MCLEAN. That is the only purpose for which they ever exchange them, is it not?

Dr. ADAMS. No. They frequently exchange at a gain.

Senator MCLEAN. But the purpose in making the exchange, so far as it affects the tax, is to take a loss, is it not?

Dr. ADAMS. They do it both ways. People may trade securities for reasons other than a gain or loss.

Senator MCLEAN. If they make a gain they do not benefit themselves, so far as the tax question is concerned.

Dr. ADAMS. My own feeling is tht we have more to gain by ignoring the losses than we have to lose by ignoring the gains.

Senator MCLEAN. Whenever they make no gains they save the additional tax. And in consequence they do not do it except for the purpose of acquiring a loss.

Dr. ADAMS. You don't have many trades now where gains are realized, because they are all taxable anyhow. They are taxable now, whether they trade or sell for cash. If you leave that door open there will be trading for gains, but you will also lock the door against acknowledgment of losses, and the question is which is the best to do.

Senator MCLEAN. If they ever sell that stock and make a gain will the tax apply?

Dr. ADAMS. Yes; if they sell it for cash.
Senator MCLEAN. You would tax them there?
Dr. ADAMS. Yes.
Senator MCLEAN. And tax them for the additional income?
Senator SIMMONS. Is it not your experience that just before the time of making reports there are in the large cities a great many exchanges of that sort for the purpose of taking losses?
Dr. ADAMS. Yes.
Senator SIMMONS. Isn't that a very great abuse?
Dr. ADAMS. Yes.
Senator SIMMONS. This would shut that off?
Dr. ADAMS. Yes.
Senator SIMMONS. That is to my mind more important than the gains.
Senator MCLEAN. They would also take the losses if they sold?
Dr. ADAMS. If they sold for cash; yes.
Senator SMOOT. If this goes out every man who wants to could sell a block of their stock to-day and take his loss and purchase it to-morrow.
Dr. ADAMS. There is that to be said about it. If you want to put it back, you can put it back in conference.
The CHAIRMAN. If there is no objection the words "For investment or" will be considered as not agreed to.
Dr. ADAMS. Coming to this next situation of subdivision (2)—
"When in the organization or the reorganization of one or more corporations a person receives in place of any such property owned by him, new stock or securities."
A number of correspondents and several employees of the department have pointed out a possible conflict between subdivisions (2) and (3), both of which relate in part to exchanges in organizations. I think the rule in subdivision (3) is safer than the rule in subdivision (2). It is proposed to say, "When in the reorganization of one or more corporations," and so forth.
Senator LA FOLLETTE. Strike out "organization or the"?
Dr. ADAMS. Yes.
The CHAIRMAN. If there are no objections, the change will be agreed to.
Dr. ADAMS. In line 3 you will see the words "However effected." I want to recommend that they be placed at the last of that subdivision after the word "corporation" in line 5. It now reads:
"The word 'reorganization,' as used in this paragraph, includes a merger, consolidation (however effected), recapitalization, or a mere change in identity, form, or place of organization of a corporation."
The change that I recommend would make it read this way:
"The word 'reorganization,' as used in this paragraph, includes a merger, consolidation, recapitalization, or a mere change in identity, form, or place of organization of a corporation, however effected."
The CHAIRMAN. If there are no objections that is agreed to.
Dr. ADAMS. In subdivision (3) the words "a group of" should be stricken out, in my opinion, and you should insert in their place the words "two or more."
Senator SIMMONS. Read it and let us see what it means.
Dr. ADAMS. "When (A) a person transfers any such property to a corporation, and immediately after the transfer is in control of such corporation, or (B) a group of persons transfers any such property to a corporation, and immediately after the transfer is in control of such corporation."
My sole point is that the word "group" sometimes means a sort of association for particular purposes, and has a restricted meaning. I want to change that to "two or more persons."
Senator LA FOLLETTE. Strike out "a group of" and substitute "two or more persons"?
Dr. ADAMS. Strike out "a group of" and substitute "two or more persons."
The CHAIRMAN. Go ahead.
Dr. ADAMS. "And when the amount of stock, securities, or both, received by such persons are in substantially the same proportion as their interest in the property before such transfer."
Senator LA FOLLETTE. It should be "interests."
Dr. ADAMS. It should be "interests."
"For the purposes of this paragraph, a person or group of persons is 'in control' of a corporation when owning at least 80 per cent of the voting stock and 80 per cent of all other classes of stock of the corporation."

In line 10 I think the semicolon should be stricken out and a comma inserted. Then in line 14 the words "group of" should be stricken out and "two or more" inserted. It has been suggested that we might better say "80 per cent of all other shares of stock." I will leave that to Mr. Beaman.

The CHAIRMAN. Go on, Doctor.

Dr. ADAMS. "(e) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (d), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor."

Gentlemen, to that section I have got to ask you to make a number of amendments. One of those is the one I read a moment ago. I see some little difficulty in reading my amendments, because they have been prepared on the basis of the House bill.

The CHAIRMAN. Is it necessary to read them? Could you not state their effect in substance?

Dr. ADAMS. Yes; I think this provision should be split into three classes, numbered one, two, and three. The first is the class I referred to a moment ago. There is no substantive change in that particular provision.

Then you would put in as clause 2 the amendment which I just read to take care of cases where property is exchanged for money and other property together. The thought is that where you exchange property for other property and money you should charge the money off against the cost of the property first; and if you get more than the cost in money, a gain should be recognized. For illustration, suppose a man has a farm and he sells it for $10,000 and some other land. Suppose the farm cost him $9,000. He would pay taxes on $1,000, and he would place the land on his books at zero.

Suppose a man has a farm costing him $10,000 and he sells it for $8,000 and a tract of land. He would credit the $8,000 against the $10,000, and for purposes of subsequent sales he would put the land on his books at $2,000.

Senator SMOOT. If he got $11,000 for it, he would pay taxes on $1,000?

Dr. ADAMS. Yes. When he sold the other property it would be all gain.

Shall I read this? I will read it rapidly. I would add the following language immediatey after line 22 on page 13:

"But where property is exchanged for other property having no readily realizable market value and money or for such property and property which has a readily realizable market value, the money or property having such readily realizable market value shall be treated as a partial or full return to the person exchanging property of the cost, and such basis as is used in this section for the purpose of ascertaining gains derived and losses sustained from the sale of such property. Any gains or losses realized from such exchanges or from the sale or other disposition of the property received in exchange shall be treated in the same manner as other gains and losses under the provisions of this section."

The CHAIRMAN. Is there any objection to the amendment? If not, it will be adopted.

Dr. ADAMS. That would be clause 2 under this subdivision. There should be another clause for this purpose. You will recall that the House bill provides later on that where property is involuntarily converted into cash by submarining or by fire and that sort of casualty and the taxpayer involuntarily realizes a gain, and the proceeds from that realization are invested in similar property, we give him a deduction. It is desirable to say that this similar property shall be placed on the books at the cost figures or basis applicable to the original property. I shall read it:

"Where property is compulsorily or involuntarily converted into cash or its equivalent in the manner described in paragraph 12 of subdivision (a) of section 214 and paragraph 14 of subdivision (a) of section 234, and the taxpayer proceeds in good faith to expend or set aside the proceeds of such conversion to the form and in the manner therein provided, the property acquired shall, for the purpose of this section, be treated as taking the place of a like proportion of the property converted."

The next paragraph would be as follows:

"Where no deduction is allowed for a loss or a part thereof under the provisions of paragraph (5) of subdivision (a) of section 214 and paragraph (4) of subdivision (a) of section 234, that part of the property acquired with relation to which such loss is disallowed shall for the purposes of this section be treated as taking the place of the property sold or disposed of."

You will recall the House provision that if a man sells securities and buys identical securities back, we shall not recognize any loss. This amendment states that in those cases, where no deduction is allowed for the loss, the part of the property acquired and relating to which such loss is disallowed shall take the place of the property sold or shall go on his books at the cost of the securities sold. For illustration, a man has a security which cost him 100 and he sells it at 80, and proceeds to buy back the same security. The House bill says he shall not claim that loss of 20. This amendment says further that he shall be allowed to keep the new security on his books at 100.

Senator SMOOT. A bank would make him take it off. Suppose you were carrying stock at 100 and it cost 100, and it decreased to 80, they always take that off. Every business should do the same.

Dr. ADAMS. Under the House bill he is not permitted to do it. If a man purchases stock for 100 and sells it for 80, and immediately buys the same stock back.

Senator WATSON. At what?

Dr. ADAMS. At 80. He is not allowed to claim that loss. It is necessary, however, to say he shall hold that stock on his books, for the purposes of subsequent cash sale, at 100.

Senator CURTIS. You ignore the illegitimate transaction?

Dr. ADAMS. We ignore the illegitimate transaction.

Senator GERRY. What do you mean by "the same kind of stock"?

Dr. ADAMS. The House bill uses the word "identical."

Senator GERRY. If he purchases different stock the provision would not apply.

Dr. ADAMS. If he purchases different stock the provision would not apply.

Senator CALDER. I go on the stock exchange on the 31st of December and sell 1,000 shares of steel.

Dr. ADAMS. Yes.

Senaor CALDER. They are sold. They are gone.

Dr. ADAMS. Yes.

Senator CALDER. An hour afterward I buy 1,000 shares of steel.

Dr. ADAMS. Yes.

Senator CALDER. Would that be "the same stock"?

Dr. ADAMS. The House bill is drawn to disallow that loss.

Senator MCLEAN. Does not the House have a provision "within a reasonable time"? It must be done right away.

Dr. ADAMS. I will read that provision, line 8 on page 37:

"No deduction shall be allowed under paragraphs 4 and 5 for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of the revenue act of 1921 where it appears that at or about the date of such sale or other disposition the taxpayer has acquired identical property in the same, or substantially the same, amount as the property sold or disposed of."

The CHAIRMAN. I think we are making the bill very complicated.

Dr. ADAMS. My only point is that if you keep the House provision in section 214 you should adopt this amendment to section 202. If you keep one you should have the other.

Senator MCLEAN. A trader would come under the definition of a man whose business is to buy and sell every day, and it would not affect him.

Dr. ADAMS. No; the dealer should not be affected by this.

Senator SUTHERLAND. By the purchase of any other stock at that time he would get his loss?

Dr. ADAMS. Yes. It might be wise to provide that every person who owns securities should inventory them at the end of the year. I understand that this amendment is adopted.

We come now to subdivision (f):

"The basis for ascertaining allowable deductions for loss, exhaustion, wear and tear, obsolescence, amortization, and other like deductions, except those authorized in paragraph 10 of subdivision (a) of section 214 and paragraph 9 of subdivision (a) of section 234, shall be the same basis as that provided by subdivisions (a) and (b) of this section."

Senator SMOOT. Is there any real reason for that? I do not quite understand it, but there may be some reason for it. Take into consideration subdivision (c), on page 12, which reads:

"In ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, proper adjustment shall be made for (1) any expenditure properly chargeable to capital account, and (2)

any item of loss, impairment, exhaustion, wear and tear, obsolescence, amortization, depletion, depreciation, or similar expense properly chargeable with respect to such property."

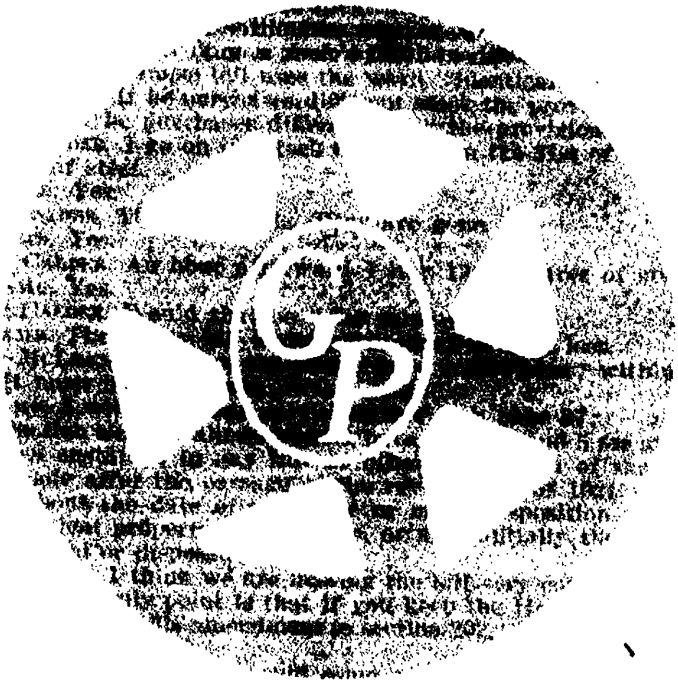
Dr. ADAMS. They are different things. Subdivision (c) is illustrated by this case: Suppose I exchange property for property in 1921 and that the cost of the old property was $10,000. I keep the old basis for the new property. I hold it until 1926. Say it is a farm, and I put on new buildings and improve it. When I sell in 1926 I do not take the basis of 1921, but I take the basis of 1921 plus the cost of the improvements, with other similar adjustments for depreciation and things of that kind.

In (f) it is stated that if you acquire property in exchange, without taxation, the deductions for depreciation, etc., are to be taken on the old basis. For illustration, suppose I have a farm and I trade it for a house. The farm costs me $12,000, and the house goes on my books at $12,000, to be depreciated on that basis year by year as I deduct for annual depreciation.

Senator SMOOT. Mr. Chairman, that brings us to "inventories," and we can not do anything with that to-day. I move the committee adjourn until Monday morning at 10.30.

The CHAIRMAN. If there are no objections, the committee will adjourn until Monday morning at 10.30.

(Thereupon, at 1.15 o'clock p. m., the committee adjourned, to meet again on Monday, September 12, 1921, at 10.30 o'clock a. m.)



INTERNAL REVENUE.

MONDAY, SEPTEMBER 12, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m. in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Gerry, and Walsh.

The CHAIRMAN. The committee will come to order.

Dr. Adams, you may proceed.

STATEMENT OF DR. T. S. ADAMS—Resumed.

Dr. ADAMS. Page 14. The section relating to inventories has not been changed.

Section 204, net losses. That has been changed and has been extended. Under the present law no net loss may be taken after December 31, 1919. We are renewing that, regarding it as very important. There is an important change in the method. We allow a loss on business of one year against the profits of a succeeding year.

Senator WATSON. A brief was submitted by some one in regard to that. Did you read that brief?

Dr. ADAMS. I will propose an amendment to cover at least one point raised in that brief. I know this man and the subject in which he is interested. At the proper time I will ask you to adopt an amendment to cover his point.

Senator SMOOT. To cover all that he wants?

Dr. ADAMS. I do not know all he wants. I have not read the brief.

Senator SMOOT. If you cover all he wants we will not have any revenue.

Dr. ADAMS. We will not do it, then.

Senator MCCUMBER. You have to consider (a) in connection with (b). In subdivision (b) you say:

"If for any taxable year beginning after December 31, 1920, it appears, upon the production 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; the deduction in all cases to be made under regulations prescribed by the commissioner, with the approval of the Secretary."

Therefore, if a person had a loss of $100,000 in 1921 and he had a gain of $50,000 in 1922, he would still have a loss of $50 000 for the next year, 1923, and if he had a loss for the next year of another $50,000, then he would pay no tax during those two years.

Dr. ADAMS. No. In other words, you let him charge the net loss of any one year against the income of the two succeeding years. Then it stops. It only covers a three-year period.

Senator LA FOLLETTE. Why do you do that?

Dr. ADAMS. Why do we do the thing at all?

Senator LA FOLLETTE. Yes.

Dr. ADAMS. One of the defects of income taxation is that we do not respect hazardous trades. The present law does not take into account the fact that the

loss of one year has to be met by the income of the next year. We tax the profit, without any deduction for loss of the preceding year.

Suppose a business makes a gain of $5,000 this year and a loss of $8,000 next year, and a gain of $10,000 the next year. We will tax the $15,000 under the present law, but really it has made $15,000 less a loss of $8,000, and it makes the tax unusually severe on the unusually hazardous industry. That is a very bad fault, in my opinion. Most of the serious difficulties in the income tax, as applicable to business concerns, may be traced back to this provision.

There is no real scientific or practical point in making just the 12 months the period.

There does come a time when you can say, this is a real period, and the three years is about it. That is a period where you have a real gain or loss. That is the reason it has been held to three years. In any event, it is sufficient for safety to the Government. Within that period it seems to me obvious that the losses of one year must be met by the profits of succeeding years, if we do not tax the gains by excessive taxes.

Senator LA FOLLETTE. Is not that equally true of professions?

Dr. ADAMS. Yes. It ought to apply to professions.

Senator LA FOLLETTE. That does not, does it?

Dr. ADAMS. We think it does; but I will ask you to put in the statement "trade or business."

Senator WATSON. You have already suggested "trade, profession, or business."

Senator SIMMONS. What is the rule now?

Dr. ADAMS. There is no rule on it now. You put in such a provision at one time, and it expired December 31, 1919.

Senator MCCUMBER. How do you determine the loss of a professional man? Suppose it is a lawyer just starting out in business, and he has no clients for a year. Has he lost anything?

Dr. ADAMS. He has not, under the statute.

Senator MCCUMBER. How are you going to determine that situation?

Dr. ADAMS. The losses are cut up into classes—those arising out of transactions entered into for profit, and those connected with trade or business. While there may be some doubtful points, we get along with that pretty well. First, we have a loss connected with the trade or business; and then we have a loss not connected with a regular trade or business, but resulting from a transaction in which a profit is realized. Then you have certain other kinds of losses, as when an automobile burns up or is destroyed or a house burns. That is the third category.

Senator MCCUMBER. Yet I do not see how you are going to determine what a professional or a mere trade loss is. A carpenter is out of employment for six months because people are not building houses. You can not say it is a loss. I confess I can not see how on earth you can apply it, unless there is something in which you have capital invested.

Dr. ADAMS. We have to be very careful of the provisions as to losses. The net losses start with the deductions which you are allowed by law. You are entitled to a deduction from your gross income. I have a modification further on about that.

Senator MCCUMBER. That is the place where you begin to tax?

Dr. ADAMS. Yes. Take your carpenter. He is not allowed any loss for failure to have employment. It is not an income-tax loss. He would not be allowed any deduction for the loss of that. It is a very real loss, but not a statutory loss for income-tax purposes.

Senator MCCUMBER. You said you were going to include the professions. I want to see what you will put in here that will cover that point.

Dr. ADAMS. Let us take a lawyer. Let us assume he gets an income of $300 or $100 a year. He does no business, but does collect $100. Suppose he has maintained a stenographer. The salary of the stenographer is a deductible expense. Now, if he pays that stenographer $1,500 a year his expenses would exceed his income by $1,400 and his loss would be that amount. Suppose he pays an office rent of $600 a year. That would be deductible expense. Suppose in connection with his business he has a variety of losses of that kind. The excess of those losses over his gross income is the statutory net loss here defined.

Senator WATSON. And the next year, if he makes a gain, it will be subtracted.

Dr. ADAMS. Yes. The definition of net loss is a term of deduction.

Senator SMOOT. Suppose he had a case where he charged a $50,000 fee on his books and did not collect.

Senator CURTIS. That was not a loss, was it, Doctor?

Dr. ADAMS. That is a question of gross income. Ordinarily, lawyers report on a cash basis. Some of them report on an accrual basis.

Senator SIMMONS. Suppose he has taken a note for his professional services which he regards as good.

Dr. ADAMS. If it becomes worthless, there is an authorized deduction for bad debts. He deducts it when it becomes worthless.

Senator SMOOT. After it is determined by the court?

Dr. ADAMS. You do not have to wait for a court's determination.

Senator SMOOT. I have a lot of notes I have taken for accounts. I know they are not good, but I do not want to take any action in court and have any record made in a public way. Do you say I can deduct those from my gains?

Dr. ADAMS. If you have returned them as income, you most certainly can deduct them when they become worthless.

Senator SMOOT. They were gains I have made in the past.

Dr. ADAMS. If you returned them as income, when they become worthless you can deduct them, and that is done every day.

Senator MCCUMBER. Suppose the man who gave a note is now dead and he has no property whatever. That is evidence enough to show it is worthless, and all you would have to do would be to deduct it.

Senator SMOOT. I have sold stock and taken part notes and part cash. Whatever I gained from that stock I returned in my income.

Dr. ADAMS. You reported the notes and cash?

Senator SMOOT. Absolutely.

Dr. ADAMS. If the notes become worthless you are unquestionably entitled to deduct them. There has never been any other rule. You are authorized to deduct them.

Senator SIMMONS. Doctor, here is a brief that was handed to me by some gentleman, who insisted that I should read it. I said I would not read it, but I would turn it over to you.

Dr. ADAMS. He has two points. One of them I will recommend that you take care of. The other is making this applicable to 1920 losses, which you have already discussed, and I do not see how the Treasury could recommend it.

Senator SMOOT. The point is as to the date at which the business terminates, in October or November, we will say.

Dr. ADAMS. That one I was going to suggest you take care of.

The CHAIRMAN. Proceed, Dr. Adams.

Dr. ADAMS. Page 15, line 5, insert after the word "any" the words "trade or." We did not think it necessary to put "profession" in, but it will do no harm to put it in if you want to. It will read, under this amendment, "Any trade or business," and if you want to make it "any trade, profession, or business," that is satisfactory. We have held "trade or business" to include professions.

The CHAIRMAN. Put it in.

Dr. ADAMS. "Any trade, profession, or business." Can not that word "profession" be left for further consideration? If we use the words "trade or business" all the way through the act it might be dangerous to mention "profession" here and leave it out elsewhere.

The CHAIRMAN. I suggest that the propriety of leaving it in or out be left to the draftsmen. The bill covers the case anyhow, and if there are no objections that will be the order of the committee.

Dr. ADAMS. In the excess-profits tax the classification "trade or business" is constantly used.

The CHAIRMAN. That will be the order of the committee.

Dr. ADAMS. The same amendment is to be made on page 15, line 14, after the word "such" insert the words "trade or business."

The CHAIRMAN. Proceed.

Dr. ADAMS. On page 16—that is Mr. Lawson's point. The section now reads:

"If for any taxable year beginning after December 31, 1920, it appears, upon the production 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; the deduction in all cases to be made under

regulations prescribed by the commissioner, with the approval of the Secretary."

If the taxable year does not begin until November they would not have a right to include losses between January and November. That seems to be a sound criticism.

The CHAIRMAN. If there are no objections, the bill will be so amended.

Senator WATSON. How do you amend it?

Dr. ADAMS. Page 16, line 11, after the word "year," insert the words "or period," so as to read:

"If for any taxable year or period beginning after December 31, 1920," and so on.

The word "period" is used to mean something besides the taxable year. We use the word "period" to mean something less than 12 months.

Page 16, line 12, after the figures "1920," insert the following:

"Or for that fraction of any fiscal year falling after that date."

Senator MCCUMBER. Maybe I did not understand what this man was asking for. I supposed he meant where a loss had occured after October 1, 1920, so as to include the part of 1920 which elapsed after that time.

Dr. ADAMS. That has to begin with some date. We begin with the date January 1, 1921. We never go back of that. The amendment as I framed it is very arbitrary. It denies the man whose taxable year did not begin until November any allowance for losses between January and November. I am trying to correct that.

Senator CALDER. If his fiscal year began June 1 of last year he would have five months of that fiscal year.

Dr. ADAMS. No; he would not have that. Nobody gets anything for the calendar year 1920, but I want to give him a loss for the calendar year 1921, and I think it is entirely just and equitable.

Senator DILLINGHAM. Doctor, I do not know as I understand this. What is the necessity of putting in the words "or period"? I thought it was covered by the second amendment.

Dr. ADAMS. Well, I want to make it perfectly plain that for that fraction of any fiscal year existing between January 1, 1921, and the beginning of the next fiscal year he gets that loss.

The CHAIRMAN. Proceed.

Dr. ADAMS. Page 16, line 23, after the word "year" insert the words "or period," just as you did in line 11.

The CHAIRMAN. You may go on, Doctor.

Dr. ADAMS. Now, gentlemen, the material on page 17 is to take care of prorating and rate changes of the taxpayer for the fiscal year. It is the same principle in the present law. It is purely mechanical.

The CHAIRMAN. If there are no objections, it will be concurred in, on the representation of the doctor.

Dr. ADAMS. There are no suggested changes at all on page 18.

The CHAIRMAN. Page 18 is agreed to.

Dr. ADAMS. There is nothing on page 19. I understand the decision was that personal-service corporations should go along with other corporations subject to later discussion.

Senator SMOOT. Mr. Chairman, do you not think we should decide the question of personal-service corporations now?

The CHAIRMAN. If the committee is ready for the question, and Senator Smoot will put it in proper form, the chair will put it before the committee.

Senator SMOOT. We strike out, on page 19, lines 18 and 20, and this amendment is carried clear through the bill:

"*Provided*, That in the case of a personal-service corporation with respect to a fiscal year, beginning in 1917, and ending in 1918, the amount specified in clause 1 shall not be subject to normal tax."

The question is whether, in the future, the normal tax shall apply to personal service corporations.

Senator MCCUMBER. If the corporation earns $200,000, and one man owns most of it, he pays 15 per cent on the $200,000; if a partnership earns the same amount doing the same kind of business, if there are two partners they earn $100,000 each and they pay on $50,000.

Dr. ADAMS. Senator McCumber, the question you raise is a grave and important one, but it is slightly different from this situation. I do not think it is the personal-service corporation that you have in mind. There are some personal service corporations, and some other kinds of corporations. That is not

what you have in mind, because the corporation with a capital can escape the surtax quite frequently. We want to meet your point.

Senator McCUMBER. I am speaking entirely of those personal-service corporations which are really professional, like accountants, architects, or physicians, which have practically no capital invested, but which, in some instances, can make enormous profits. You allow them to escape almost entirely, while an individual partnership in the same business pays four or five times the amount of tax they would pay. There should be some way to equalize that.

Dr. ADAMS. May I ask whether your thought embraces not only professional corporations, but also embraces the case of a rich individual who owns a block of stock or bonds, and that individual, in order to escape the surtax, incorporates his property. He then has an investment company, which is just what it was before when he was managing it. Those have been the cases which seem to me the more discussable cases, rather than professional cases, because the great part of the professional corporations do not get above the 15 per cent rate. Does your thought include the latter case? If it does, we will have a slightly different definition for the corporation.

Senator McCUMBER. My idea is to have it include everything where capital investment is not considered. I am not making a distinction now between incomes from business matters and incomes from interest, but in the ordinary run of business there are two kinds. There is the individual or partnership, which is treated as an individual. Then there is the personal-service corporation. They do business exactly as the partnership, the same kind of business, the same as the individual, and by incorporating and putting one or two others, if they are doing an enormous business, they can escape taxation.

Dr. ADAMS. If you make that turn on the possession of capital all these corporations will get some capital. It is easy for them to keep some of their earnings and thereby obtain some capital, which they use in their business, if they are very prosperous. If they are not prosperous, you reduce your taxes by the method you propose. The point I make is whether that use of a corporation to evade the surtax should cover the investment corporation as well as a professional corporation. If it does, do you not want to put in a new definition of a class of corporations, to be treated as partnerships, rather than utilize the present definition of personal-service corporations?

Senator McCUMBER. I had not thought about that feature of it. Take a physician who has quite a reputation. He capitalizes his good will for $1,000,000. He takes in a couple of internes and gives them $1,000 each of the capital stock, and incorporates. He is making two or three hundred thousand dollars a year. He never has to go above 15 per cent, while your architect or your partnership must pay any amount of surtax. I am simply trying to see if there is not some way where you can make people doing the same kind of business without capital investment pay their taxes according to their earnings, which would be as heavy upon the one as upon the other. I do not say it can be done, but it seems to me there should be some means of reaching it.

Dr. ADAMS. We are trying to draft something to cover that. My point is that you do not want to apply the doctrine or method you have in mind to personal service corporations. You want to apply it to a new category of corporations, newly defined, and we are working on that and will submit it to you later.

Senator McCUMBER. Until you submit that I do not know how to vote on it.

Dr. ADAMS. A personal-service corporation does not get the treatment you want. They can avoid it by acquiring a little capital. A personal-service corporation was designed for one thing only, and that was to get them out from under the excess-profits tax. The excess-profits tax was based upon capital invested in the business, and it would have compelled a personal-service corporation to pay a very high tax because it uses very little or no capital.

Senator SIMMONS. That was the only reason for putting personal-service corporations upon a parity with partnerships, because we wanted to relieve them from the excess-profits tax, and that was because we could not find any capital to base it on.

Dr. ADAMS. Yes.

Senator SIMMONS. If Senator McCumber is correct in his statement, then I do not understand the personal-service corporation tax. Let me see if I understand it. My understanding is that a personal-service corporation would pay a tax of 15 per cent upon its net income.

Dr. ADAMS. A personal-service corporation?

Senator SIMMONS. Yes.

Dr. ADAMS. No; it would be taxed as a partnership. We have to subdivide the individual stockholders and tax them.

Senator MCCUMBER. Under the existing law?

Dr. ADAMS. Under the existing law. Under this bill it would be put in at 15 per cent like other corporations.

Senator SIMMONS. If that is done, they would pay 15 per cent flat tax and divide their profits, and then each stockholder would pay on his part of those profits.

Dr. ADAMS. It is taxed exactly like any other corporation.

Senator SIMMONS. This is proposed to tax them practically like a partnership?

Dr. ADAMS. No. The present treatment is to do that. We do it now, and under this law we would tax them as a corporation.

My sole point is that you have two slightly differing problems. Obviously the excess-profits tax can not apply to a corporation that has no capital, because it is based on capital. For that reason we excluded the personal-service corporation and classed it as a partnership. When the excess-profits tax is abolished, if you do abolish it, then the personal-service corporation as such should not be subject to special treatment.

Then you come to this other problem of individuals using a corporate form in order to escape the surtax. That still remains. It is a slightly different problem. Do corporations use the corporate form in order to escape the surtax? If so, what kind of a corporation is it? Let us define them and treat them as partnerships.

Senator MCCUMBER. There is another feature that you have not considered. Under the decision of the Supreme Court, where this personal-service corporation has earned money which it does not need to use it may only declare dividend enough to meet the requirements of its individual stockholders for that year, and you can not tax the remainder like you could a partnership. In other words, if a corporation does not distribute its earnings you can not tax the individual his undistributed share of the earnings of that corporation. That was brought about by the decision of the Supreme Court since our last law was enacted. Under the law as it then stood, which considered the earnings of a personal-service corporation as though they had been distributed to the individual stockholders, we got the full tax on it the same as any corporation. Now, under the decision of the Supreme Court, you can not get that if they do not divide it. I want some means by which you can make a tax that will be equitable to a partnership and will cover that point, even though the funds are not distributed, because you tax the partnership even though the funds are not distributed. Can you get up something that will meet that?

Senator WALSH. Mr. Chairman, I understand Dr. Adams says he will prepare a provision which will define a class of corporations that some of us desired to include on the partnership basis. What is the use of spending any more time on this until that is prepared and we can vote on it?

The CHAIRMAN. Is that ready?

Dr. ADAMS. It is not ready.

Senator SIMMONS. What is the purport of it?

Dr. ADAMS. I can not tell you that. We are seeking to find out the class of corporations that should be covered by that definition. The Supreme Court has just decided that as a general proposition you can not tax to the stockholders the undistributed profits of a corporation. There are certain classes of personal-service corporations which are within that decision. The decision wipes out the treatment of the personal-service corporation.

Having done that, you attack a slightly different problem. Can we define with such clarity and persuasiveness the class of corporation that is used in the corporate form in order to evade the surtax that the Supreme Court will permit us to deal with them as a partnership; I am trying to do that, and it requires a good deal of thought.

Senator MCCUMBER. Let me give you a suggestion to think over along that line, to see if it will escape the decision of the Supreme Court. Suppose you take a personal-service corporation and consider them in a class by themselves, as a corporation having a different rate of tax than the business corporation, but provide that the tax upon the net corporate earnings shall be of such an amount as would be equivalent to the tax which would be paid by a partnership to the several partners, supposing they had no income outside of that business, and according to the stock which they held in the corporation. Do you catch my meaning?

Dr. ADAMS. Yes. I have considered 50 schemes. I will bring you the one that most appeals to me, and I will explain the others.

Now, if you will consider this I think you will see after a time that to impose this especially drastic tax on personal service corporations and not apply it to the class of investment corporations I spoke of, what you would do would be to apply an especially drastic and rigid method of taxation to professional earnings which were made without any capital behind them, and to leave out the gentleman of leisure who has nothing at all but investments. I think your logic and your philosophy include the lawyer class.

Senator MCCUMBER. Certainly they do.

Dr. ADAMS. That is the reason I say you are safe in abolishing the personal service corporation treatment, because that is not the kind you want to deal with in that way.

Senator WALSH. Have those investment corporations increased rapidly in recent years for the purpose of evading taxation?

Dr. ADAMS. Senator, I can not say that. I know they have increased, but there are other reasons behind the increase. The worst cases of that kind that I have met with are corporations that were created before the income tax was formed.

Senator WALSH. In other words, when this income tax bill was originally drafted they did not take enough precautions to take care of that class of corporations?

Dr. ADAMS. It has been a serious situation since the famous section 3 of the revenue act of 1913, or at least since 1916. That section has never been enforced. It is a section that is now in the bill as section 220. That is the reason that I did not hasten with that draft and bring it here this morning. This has been a topic of much discussion before this committee. You will remember Senator Jones with his famous thesis. It has been repeatedly discussed. It is a very real evil. The difficulty has been increased by the recent decision of the Supreme Court.

Senator SIMMONS. That is the source of the discrimination you are talking about.

Dr. ADAMS. Yes.

Senator SIMMONS. Would it be feasible, in order to coerce the distribution of as much of these earnings as are practicable, to impose a higher tax upon that part of the earnings which is not distributed than upon that part which is distributed?

Dr. ADAMS. Look at the remedy which is provided in section 220. It is the best solution which has yet been devised. Put a large additional tax on the corporation that falls within the scope of that section 20 or 25 per cent.

Senator MCCUMBER. I do not care whether it is done to evade or otherwise.

Dr. ADAMS. That is the difficulty with section 220 at the present time.

Senator SIMMONS. We said we put that provision in to accomplish that purpose, but it has not accomplished it.

Dr. ADAMS. You are quite right. The difficulty is in the failure to define their scope. I think that method is the best.

Senator SIMMONS. I have a good deal of confidence in your being able to draft something effective along that line. Do you think it would be feasible to impose a heavier tax on the undistributed earnings?

Dr. ADAMS. On all corporations?

Senator SIMMONS. Yes.

Dr. ADAMS. I think it would be; yes.

Senator SIMMONS. Why is that not the remedy? That would force them to distribute every cent they could without serious injury to the business.

Dr. ADAMS. Most people do not want to force distribution.

Senator SIMMONS. I want to either force them to distribute or pay their proper share of tax, in order to equalize the tax they pay with the tax an individual pays. If we eliminate the excess-profits tax and then impose a 15 per cent tax on corporations, and retain the present normal and surtax on individuals and on copartnerships, we have got to do something.

Dr. ADAMS. You have done something.

Senator SIMMONS. What is it?

Dr. ADAMS. Seven per cent additional on the normal rate. You have a 7 per cent higher tax on corporations than on individuals.

Senator SIMMONS. Can you tell us about what proportion of the earnings of corporations are distributed?

Dr. ADAMS. From 65 to 70 per cent are distributed. Distributions were very much less than that during the war. In the present year they will distribute more than 70, because they are forced to retain sufficient in the corporation to maintain itself, and that was appproximately 35 per cent before the war.

Senator SMOOT. In writing a provision in reference to personal-service corporations you must not forget this fact, that a partnership can make $68,000 with only two partners and pay practically the same rate as a personal-service corporation would pay if they made only $34,000. In other words, if the personal-service corporation pays 15 per cent it pays it on an amount not exceeding $34,000. If it is less than $34,000 they are penalized. At the same time this partnership can make twice that amount and divide it between the two partners, which would be a total of $68,000, and would pay exactly the same tax as the corporation would if there were only two men in the corporation.

Dr. ADAMS. I think that figure should be $39,000 instead of $34,000. The 15 per cent would average $39,000. It strengthens your argument.

Senator MCCUMBER. The injury would be done where the earnings are big and they do not have to distribute them.

Dr. ADAMS. Yes. You can settle this question without delay. You have three problems. First, you want to deal with one corporation like you would another, on an equitable basis. Second, you want to try to isolate and deal effectively with the class which is utilizing the corporate form to evade the surtax. Then you have Senator Simmons's proposition of imposing some tax upon undistributed profits which will more or less equalize those of the individual or partnership. That is an entirely different proposition. There are at least a dozen genuine methods of accomplishing each of those last two things. If you want to settle this on principle it may save a lot of trouble. It sometimes takes days to draft one of these proposals.

Senator MCCUMBER. You must bear in mind all the while that we are taxing ability to pay. When you try to penalize a regular corporation by adding the surtax or taxing the amount which they withhold, it seems to me you are affecting not only the corporation but a good many stockholders. We want this to apply to personal service corporations and copartnerships and individuals who receive large incomes, and if they have not the ability to pay they should not be taxed.

Dr. ADAMS. I have no method to propose here. All this has been gone over with the Secretary of the Treasury, and he has recommended what is before you.

Senator CURTIS. Doctor, have you recommended the amendment adopted by the House?

Dr. ADAMS. Yes.

Senator CURTIS. Why should we not adopt that and then have you prepare an amendment to reach men who are handling their affairs in a way to escape the tax?

Dr. ADAMS. That is what I want to do. Senator Simmons injected another proposition.

Senator GERRY. Is that not the Jones amendment over again?

Senator WATSON. Do you not think, by your process of segregation, you can remedy this evil without taxing undistributed earnings?

Dr. ADAMS. Gentlemen, you put on the corporation a normal tax of 7 per cent in advance of that on the individual. There is no possibility of equalizing every case. In the average case it will more than equalize it. That is the only truth you can come to. If the average partner pays less than 15 per cent, the 15 per cent tax on the corporation will put the average corporation above the average partnership. Unquestionably the partners will pay two or three times as much more as partners than they would pay as corporations; but, on the average, the 15 per cent rate will be more than compensatory, because the average person does not pay 15 per cent. You do not reach the 15 per cent rate, even as an average, until the income gets to $39,000. The average ordinary partner has not an income of $39,000 a year. Accordingly, then, the corporation rate on the average is greater.

That is not a scientific proposal, but it takes you infinitely far afield if you want to do the exact thing.

Senator SIMMONS. I want to hear Mr. McCoy on this. When we made the last bill Mr. McCoy was constantly making estimates, and when we got to a case of this sort Mr. McCoy gave us voluminous figures to show us whether there would be a discrimination or not. I think we ought to hear from Mr. McCoy. Dr. Adams is an expert on many lines, but Mr. McCoy is an expert on

these particular lines on which we want information right now. I would like very much to have his views about it.

The CHAIRMAN. Mr. McCoy?

Mr. McCOY. I have not been following the discussion very closely, Senator, but my idea about this, with reference to putting the tax on corporations, partnerships, and individuals upon a parity, is that, of course, by doing away with the excess-profits tax you do away with that parity.

Then, again, it depends altogether upon the size of the corporation.

Senator SIMMONS. Mr. McCoy, did you not relieve copartnerships and personal-service corporations from the excess-profits tax for the purpose of producing parity?

Mr. McCOY. Yes.

Senator SIMMONS. If you take the excess-profits tax away you produce disparity. Is that disparity made up by increasing the corporation tax to 15 per cent instead of——

Mr. McCOY. It is made up to a large extent by increasing the corporation tax to 15 per cent, or decreasing the higher surtax brackets. Of course, no matter how we fix it, the different-sized corporations as compared with different-sized individuals or different-sized partnerships will not pay the same tax.

Senator SIMMONS. How about those individuals and corporations that would not be included in the surtax if you reduced it from 65 to 32 or 25 per cent?

Mr. McCOY. That will have a tendency to put them more on a parity, very much more, by reducing the higher surtaxes. The very large partnership paying as a partnership would pay very much more than a corporation with the same invested capital and the same income.

Senator SIMMONS. Under the present law?

Mr. McCOY. Under the present law. And to alleviate that we gave them the right to incorporate within a certain time after the law went into effect and still pay as a corporation. If we cut the higher surtaxes it will tend more to let the larger partnership, as a partnership, pay the same as a corporation.

Senator SIMMONS. How about the smaller partnership?

Mr. McCOY. The smaller one probably would pay less now.

Senator SIMMONS. You mean under the Fordney bill?

Mr. McCOY. Under the Fordney bill; yes; with the 15 per cent instead of 12½. They would have to have a very large income to bring the average of the partnership up into the 15 per cent bracket.

Senator SIMMONS. Why can you not start with an income of $50,000 and take each one of the brackets, with the Fordney rate, and compare the individual and the copartnership and the corporation upon that basis?

Mr. McCOY. It would depend very much upon the distribution.

Senator SIMMONS. Can you not work those sums out for us?

Mr. McCOY. Yes; that can be worked out.

Senator SIMMONS. It seems to me that if you should start with an income of, say, $25,000 or $30,000, or anywhere along there, and then work out the tax which the taxpayer would pay, whether he is a corporation, an individual, or a partnership, under the Fordney scheme as it is proposed to amend it by this committee, raising it from 12½ to 15 per cent on corporations, it would be very valuable information.

Mr. McCOY. I have worked out a number of these taxes.

Senator SIMMONS. I know, Mr. McCoy; but it will be much more satisfactory if you will just work out the class included in each one of the brackets. It is an easy matter when you go to make figures to pick out individual cases and get a result; but if you will start now at the very beginning and follow these brackets up and give us the result in each bracket, then we will have something that we can make an average on. You can do that. That can be done, and that is information that this committee is entitled to. It does not signify anything to me that you tell me that a big corporation with a certain income will pay more than a copartnership and that a big partnership with a certain income will pay more than a corporation. That does not mean anything to me. But if you take each one of those surtax brackets and take the income of a corporation at that figure and the income of the individual and the income of the copartnership at that figure, and then show me the amount of tax which each one would have to pay within those brackets, that will mean something to me. That could be done, I think, and it does not require any great amount of work.

Mr. McCOY. I have an illustration right here—a net income of $1,000,000. The maximum surtax rate is 32 per cent. The taxpayers, the partners, and

the stockholders are heads of families, so that they will have larger exemption. I have the individual with $1,000,000 net income——

Senator SIMMONS. That is as strong as you can put it in favor of the individual.

Mr. McCOY. He will pay 38.7 per cent of his total income.

Take a partnership. If there were two partners they would pay 37.3 per cent—about 1 per cent less. If there were four partners they would pay 35 per cent. If there were five partners they would pay 34 per cent. If there were eight partners they would pay 30 per cent; the number of partners of course going down into the lower income-tax brackets.

Take corporations. I have three kinds. Assume the first distributes 50 per cent of the profits. If there were 4 stockholders the tax would be 26 per cent of the income. If there were 5 stockholders, 25 per cent; 8 stockholders, 22 per cent; 10 stockholders, 20 per cent; 20 stockholders, 17 per cent.

Assuming that they distribute $750,000 of their income, 4 stockholders would pay a total tax—income, and corporation tax—of 34.5 per cent; 5 stockholders, 33 per cent; 8 stockholders, 30 per cent; 10 stockholders, 27 per cent; 20 stockholders, 20 per cent.

Assuming that they distribute all of their net income, we find where the corporation will pay more than the individual——

Senator SIMMONS. That is the milk in the coconut. If they distribute it all they are something like equal.

Mr. McCOY. It is about the same—37.75 per cent. The individual pays 38. It is almost the same. If there are 5 stockholders it is 36¾; 8 stockholders, 33¼; 10 stockholders, 31.

Senator SIMMONS. When you come to the individual, you have given the individual a large family?

Mr. McCOY. I just gave him the $2,000 exemption.

Senator SIMMONS. I misunderstood you.

Mr. McCOY. The head of a family, without children—I gave the $2,000 exemption.

Senator SIMMONS. That seems to be a fair way of working it out.

Now, Mr. McCoy, I want to ask you this question: You start with a corporation with four stockholders. That is not much more than a copartnership. Can you not ascertain about the average number of stockholders in corporations?

Mr. McCOY. It depends so much on the size of the corporation.

Senator SIMMONS. For instance, suppose you start with the surtax bracket of 3 cents, we will say, and give us an illustration just like the other one, based upon the income in the 3-cent bracket. Then go to the next bracket and give us an illustration. In each case you will have the size of the income. You know about the average number of stockholders in corporations of that size. Can you not ascertain that?

Mr. McCOY. Yes, sir.

Senator SIMMONS. If you will do that and make your calculation that you have made on $1,000,000 basis, you will demonstrate that either I am wrong or Senator Smoot is wrong.

Dr. ADAMS. You have got to add another thing to it before your illustration will mean anything.

Senator SIMMONS. Add everything that ought to be added.

Dr. ADAMS. You have got to see to what extent the stockholders hold stock of other corporations.

Senator SIMMONS. May not partnerships be in the same fix?

Dr. ADAMS. Yes. You will settle that question on policy, not on the details of the draft. That is the reason I asked you to settle it. I do not know whether you recall it or not, but while surtaxes stayed at 65 per cent I told Secretary Houston that I thought that a scheme of taxing the undistributed profits of corporations, with reservations or modifications, by which they could elect to pay taxes as partners and get rid of the tax on undistributed profits was very well worth considering. He recommended it.

Secretary Mellon, however, is against it. I have discussed it with different corporation organizations. With one exception they have turned it down. The National Association of Credit Men have indorsed it. The proposal has been turned down in this committee a dozen times in the past. It is opposed by 19 business men out of 20. The plan would be practicable. It is a trifle complicated, but you can get the machinery to take care of it if you want it.

But the question will be settled not on the machinery but on the question of policy involved.

Senator WALSH. I move that a provision be drafted by Dr. Adams providing that if it appears that the corporation tax imposed by this bill on personal service corporations and investment corporations be less than the imposition of a partnership tax on the stockholders of personal service corporations or investment corporations, then the partnership tax provisions of this bill shall apply to such corporations.

The CHAIRMAN. Dr. Adams, we have threshed these questions over and we do not seem to be any nearer an equitable adjustment than before. Does it look any more promising at this time?

Dr. ADAMS. I think you, perhaps, have not considered this aspect of the question:

The corporation rate which you have imposed is 15 per cent. That is more than 7 per cent in excess of the normal tax on the individual. If the average corporation distributes, as I think it does, about two-thirds of its net income and retains about one-third, then a 15 per cent tax on its entire income is equal to a tax of 21 per cent upon its undistributed income. Under the proposed 15 per cent rate, therefore, on the average corporation you would be imposing an additional tax equivalent to 21 per cent upon the undistributed earnings—additional to the normal rate on individuals

As I see it, illustrations do not help you. Anything can happen.

I was going to draft something along the lines suggested by Senator Walsh. I wish you would rather leave me uninstructed.

Senator WALSH. I am simply trying to help to get something upon which to vote. We can not vote on something that is in the air. I am trying to get something in language which will put these corporations on the same basis as partnerships which, it appears, are getting the better of the tax by reason of not being incorporated.

I will make separate motions, one relating to personal-service corporations——

Senator WATSON. I second the motion as to personal-service corporations.

Senator WALSH. I will strike out the reference to investment corporations, for the time being.

The CHAIRMAN. The motion as modified is agreed to, and the matter will be reported on by Dr. Adams at an early date.

Now, Doctor, what is the next subject?

Dr. ADAMS. On page 20 you come to the provisions relating to capital gain and capital loss. I have to request that you let that go over until to-morrow.

The CHAIRMAN. All right, sir; it will go over.

Dr. ADAMS. On page 23 you have nothing. It stands exactly as it is.

On page 25 you come to the question of the limitation on the surtax.

Senator MCCUMBER. The taxes and normal surtaxes are not reduced at all except in the higher brackets for any of the future years?

Dr. ADAMS. They are reduced by these exemptions, Senator. They put up the personal exemption. The brackets are not changed, in the lower brackets.

Senator MCCUMBER. We ought to decide the question of exemptions.

Dr. ADAMS. You have done something for the little taxpayer in the exemptions; you have done nothing in rates.

Senator MCCUMBER. I am afraid you are losing so much by those big exemptions. Have you worked out how much you will lose?

Dr. ADAMS. Mr. McCoy has figured it at $70,000,000, for both of them.

The next real point is on page 28——

Senator SMOOT. What do you want to do about page 23?

Dr. ADAMS. There has been no change in the law proposed.

Senator SMOOT. Why put that (*a*) in there at all?

Dr. ADAMS. That is the present law. Everything that is here is the present law. That will be taken out of the House draft.

Senator SIMMONS. Doctor, what I am talking about is not whether the House has made any change in the present law, but whether we want to make any change in the present law. We have as much right to make a change as the House has.

Subsection (*b*) reads:

"For each calendar year thereafter, 8 per cent of the amount of the net income in excess of the credits provided in section 216."

We reduced that from 12 to 8 per cent. If it becomes necessary to bring about equality of treatment between corporations and individuals, what would you think of reducing that to 6 per cent?

Dr. ADAMS. It would cause that much less revenue. That is a question altogether for you gentlemen.

Senator SIMMONS. We have been losing revenue in certain directions and making up for the loss in other directions. What I have in mind now is equality. Do you think if we were to reduce it it would bring about equality between the corporation and the individual, if there is an inequality?

Dr. ADAMS. I want to ask you a question. You can not get equality in every case. Anything can happen——

Senator SIMMONS. You can approximate it.

Dr. ADAMS. You only get equality in the average case. If you take the average taxpayer, I think Mr. McCoy's figures will show—although he should confirm them—that the 7 per cent additional on the corporation makes more than equality. I would like to have that checked. If we seek out the average-sized corporation and the average partnership, dealing with the average men all the way through, I am inclined to think that the 7 per cent additional on corporations more than makes it up.

Senator SIMMONS. It may be that you are right, but I do not think you are.

Dr. ADAMS. You can not settle this question by the thought of equalization. No single rate will equalize in every case.

Senator SIMMONS. I qualified that. We all know that you can not do it mathematically, but it can be approximated. If there is a glaring inequality, certainly that would be an injustice, and we ought to try to so adjust the matter that the inequality that exists will not be a glaring and wrongful inequality?

Dr. ADAMS. When you come to the question of rates, the amendment on page 28, will not that send you back to discuss all these rates?

The CHAIRMAN. The committee will proceed to the consideration of page 28, lines 16 to 19, paragraph (c).

Senator CURTIS. Was there not an agreement the other day that an amendment was to be proposed putting that in brackets?

Dr. ADAMS. Mr. McCoy was going to suggest to you something in connection with that. I think he is working on it now—are you not, Mr. McCoy?

Mr. McCOY. Yes.

Senator WATSON. Have you it now?

Mr. McCOY. I have it ready.

Dr. ADAMS. I understand that subdivision (c) will bring up the whole question.

The CHAIRMAN. Let us go ahead with that, then.

Dr. ADAMS (reading). "(c) For the calendar year 1922, and each calendar year thereafter, the rate upon the amount by which the net income exceeds $66,000 shall be 32 per centum instead of the rates specified in subdivision (a) in respect thereto."

Senator WATSON. Mr. Chairman, I move we hear from Mr. McCoy.

The CHAIRMAN. Mr. McCoy will now be given an opportunity to express his views.

Mr. McCOY. I have prepared tables showing, for every income mentioned in the present law and the proposed law, the tax and the percentage of tax on the total income. For example, a $3,000 income under the present law has a tax upon it of 1¼ per cent, while a $12,000 income is 6 11/12. I have not had this typewritten yet. I have been working on it until the last minute, but I have it all here.

The CHAIRMAN. You will have your figures inserted in the stenographer's notes.

Mr. McCOY. Yes. I have taken 32 per cent as the maximum under the Fordney bill and prepared tables showing the rate there in order to lower the lower income tax bracket, and, at the same time, with 32 per cent as the maximum. I have two or three suggestions; that is, to drop 1 per cent off each rate from the beginning to $50,000.

Senator GERRY. Does that mean surtaxes?

Mr. McCOY. I am dealing with surtaxes only.

Take off 1 per cent from each surtax rate from $5,000 to $50,000, and then at $50,000 impose the flat 32 per cent. Six thousand dollars would be the exemption instead of $5,000, really, because the first bracket is 1 per cent of the excess over $5,000, and not in excess of $6,000. That would make $6,000, really, at the beginning.

We would lose something like $40,000,000 in revenue.

If instead of beginning with 32 per cent at $50,000 we begin at $60,000, there would be a loss of a little less than $30,000,000.

Senator SMOOT. What would you do between the 34 per cent and the 60 per cent?

Mr. McCOY. Just drop 1 per cent off each bracket.

Senator SMOOT. Along up to 60 per cent?

Mr. McCOY. Yes, sir. The $58,000 to $60.000 would be 27 per cent instead of 28 per cent.

Senator SMOOT. I thought you said take one off from $50,000 down.

Mr. McCOY. The first suggestion was 1 per cent up to 24.

Senator SMOOT. The next is what?

Mr. McCOY. One per cent off up to $60,000. That would reduce each bracket 1 per cent.

Senator GERRY. And what would we lose?

Mr. McCOY. A little less than $30,000,000. It makes a net of $30.000,000. You gain less than a million over the $60,000, but you gain about $31,000,000 from $60,000 down. That is a net gain. If, instead of giving the additional $500 exemption to the head of a family with an income of less than $5,000, you abolish that, there would be no loss. That would just offset the loss.

The next would be 2 per cent. If that is too great, you could drop 1 per cent off each bracket up to $30,000. That would be up to the 12 per cent bracket.

Senator SMOOT. What would we lose?

Mr. McCOY. $26,000,000. Drop 1 per cent up to $30,000. Begin increasing the rate at $54,000. Continue the present rates from $30,000 to $54.000. Then from $54,000 to $56,000 make it 27 per cent; $56,000 to $58,000, 29 per cent; $58,000 to $60.000, 32 per cent; and thereafter, 32 per cent. You would only lose $16,000,000.

Senator CURTIS. Why could you not arrange that so that it would be about the same without disturbing the exemption?

Mr. McCOY. You would have to increase the tax on somebody if you get the same revenue. I am trying to get practically the same revenue without increasing the tax on anybody.

Senator CURTIS. And under your last statement it would only make a loss of about $15,000,000?

Mr. McCOY. But if you abolish the $5,000 you would have a gain of $25,000,000.

Senator SIMMONS. Where do you begin with the 2 cents?

Mr. McCOY. Take 1 per cent off each bracket up to $30,000. From $28.000 to $30,000, instead of being 13, it would be 12. The 13 per cent bracket from $28,000 to $30,000 would be 12 per cent. Then adopt the present rates from $30,000 to $32,000, or until you get to 25 per cent, which is the percentage on $52,000 and does not exceed $54,000.

Then, from $54.000 to $56,000 make the rate 27 per cent; $56,000 to $58,000, 29 per cent. Over $58.000 pays 32 per cent.

Senator WATSON. What does that do to the revenue?

Mr. McCOY. There is fifteen millions loss.

Senator SIMMONS. Suppose you were to go on by the same process to 32 per cent——

Mr. McCOY. I have reached 32 per cent, Senator, at $58,000. Over $58,000 they pay 32 per cent.

Senator SIMMONS. Suppose you continue the same process up to $68,000, what rate would you reach?

Mr. McCOY. That would be 38 per cent. That would probably make some people pay more than they are paying now, people who get from $63,000 to $66,000.

Senator SIMMONS. All over $58,000 will pay 32 per cent?

Mr. McCOY. Yes.

Senator SIMMONS. How much revenue would you lose by that?

Mr. McCOY. Under the present law about $95.000,000.

Senator MCLEAN. On what income does the 32 per cent apply now?

Mr. McCOY. $66,000 to $68.000.

Senator GERRY. How much does the Government receive on the normal tax?

Mr. McCOY. About $450,000,000.

Senator SIMMONS. How much would it receive by your proposition?

Mr. McCOY. I have not changed it. The normal tax remains the same. The House bill changes that by $70,000,000.

Senator SUTHERLAND. Are your figures based on the returns for last year?

Mr. McCOY. On an estimate for the year 1922, based on all the returns up to date.

Senator SUTHERLAND. What is the loss in brackets up to $28,000?

Mr. McCOY. Of course, the principal loss is in the lower brackets, because there are so many of them. I can tell you exactly the number in each bracket if you would like.

Senator SUTHERLAND. No; just approximately. Where you take the same figures that you have now, up to $28,000, you have a reduction of 1 per cent in every one. You cut out the first bracket and then you reduce all of them 1 per cent up to $28,000?

Mr. McCOY. From $30,000 up you lose $4,000,000, while under that you lose $26,000,000.

Senator SMOOT. Providing you do not increase the 26 and 27 per cent on page 26.

Mr. McCOY. No; you begin at $60,000 with 32 per cent. You gain a little bit. You gain less than $1,000,000. I have tried to get no one to pay more tax.

Senator CALDER. I move that we agree that the surtaxes now effective shall be operative for this calendar year, as the House bill provides.

The CHAIRMAN. As of January 1, 1921?

Senator CALDER. That the taxes collected on incomes for this year be the same as they are to-day. I mean as contained in the House provisions. Let us agree on that.

Senator SMOOT. I second that motion.

(The motion was agreed to.)

Senator SMOOT. I move that the normal tax of 8 per cent can be agreed to, beginning January 1, 1922. I want to continue the existing law.

Senator WATSON. I second the motion.

Senator CURTIS. If you do that you will have to reconsider the vote you took the other day in regard to the excess-profits tax.

Senator SMOOT. No; this is as to individuals.

Senator CURTIS. I know; but the same principle applies. If you are going to make this retroactive you ought to make them all retroactive.

Dr. ADAMS. It has been 8 per cent since 1918.

Senator SIMMONS. I want to say that I expect to get certain information, and later on I shall offer some amendment as to this. I do not desire—in fact, I am not ready—to vote on this proposition now, because I expect to offer an amendment, in all probability.

Senator SMOOT. The only reason for making that motion at this time is this, that I am quite sure you have got to have an 8 per cent normal tax in order to raise the money that you want to raise.

Dr. ADAMS. Don't you want to have both of them, Senator?

Senator SMOOT. That is what I say—both of them.

The CHAIRMAN. What is the motion?

Senator SMOOT. That the committee agree to the present rates of 8 per cent and 4 per cent, as provided in the existing law; that is what the House passed.

(After voting.)

The CHAIRMAN. It is agreed to.

Senator GERRY. For the same reasons expressed by Senator Simmons, I desire not to vote on that question.

Senator WATSON. Let me ask a question. We have voted to repeal the excess-profits tax, retroactive January 1. We have voted on this proposition of the surtaxes and on personal income not retroactive. How do you distinguish between the two?

Senator SMOOT. I think there is quite a difference between the excess-profits tax and the individual income tax, for this reason: The income tax is a tax that will be imposed here always, and it is a fair tax falling upon the person according to his ability to pay. We begin with a low tax of 1 per cent, and we go on up. That is the policy. I think that the income tax, no matter whether for this year or next year, ought to be enforced. The only reason that we say now we are not going to put this in here—that is, have the old rates—is that with the high brackets the money that is made is put into tax-exempt securities. That money, so far as the individual is concerned, has been made up. He has made it up for this year.

Senator CURTIS. How about the excess-profits tax? Has he made that, too?

Senator SMOOT. I do not know whether he has or not.

Senator SUTHERLAND. Is it necessary to reenact paragraph (a)?

Dr. ADAMS. That will go out.

Senator SUTHERLAND. Why isn't it stricken out now?

Senator MCCUMBER. Let us decide this question of 8 per cent.

Dr. ADAMS. The next question concerns a decision as to the maximum surtaxes, the year in which they are applicable, and the interior brackets on the sur-

taxes. Mr. McCoy gave you a very interesting plan, if you want to enforce it. I wish, Mr. McCoy, you would repeat the substance of your plan.

Senator CALDER. Before he does that, would it not be well to determine whether we are going to reduce the surtaxes for the next year? Then we can work on the rates in between afterwards.

The CHAIRMAN. I think so.

Senator CALDER. I move, therefore, Mr. Chairman, that we agree to the House provision on page 28, marked subdivision (c).

Dr. ADAMS. Do you want to include $66,000, or do you want to specify the point where the 32 per cent rate begins?

Senator CALDER. No.

Dr. ADAMS. You want the 32 per cent maximum, but not to go into effect until 1922.

The CHAIRMAN. That has been decided.

Senator CALDER. Not by the committee.

Senator WATSON. The Republican members decided that by a majority of 1.

The CHAIRMAN. Then, what is the motion? Mr. McCoy says that was voted on.

Senator WATSON. We voted, as I remember, to continue it throughout this year; we did not vote on the 32 per cent maximum.

Senator CALDER. That is my motion now.

Senator SIMMONS. Beginning January 1, 1922?

Senator WATSON. That is the motion now.

The CHAIRMAN. Does some one offer to make it 25 per cent?

Senator SIMMONS. No one has so far.

The CHAIRMAN. I thought I might like to.

Those in favor of making it 25 per cent will signify by raising their right hand.

Senator WATSON. I voted the other day with the Republicans to make it 25 per cent. The majority voted the other way, and I am going to stay with the majority.

(After a vote.)

The CHAIRMAN. It is not agreed to, the vote standing 8 to 2.

The question now recurs to the motion of Senator Calder to agree to 32 per cent. Is there any objection to that motion?

Senator CALDER. With maximum rates of 32 per cent.

Dr. ADAMS. After January 1, 1922.

Senator CALDER. Yes.

(After a vote.)

The CHAIRMAN. It is agreed to.

Senator SMOOT. As to the brackets, we will wait until he has worked that out.

The CHAIRMAN. Yes; the brackets will go over until Mr. McCoy completes his analysis.

Senator MCCUMBER. In connection with these brackets we will have to consider the subject of exemptions.

Dr. ADAMS. I think, as you are on this subject of rates, it will be desirable to take up the subject of the two exemptions. They are not specified in this section, but they are referred to in this section and come shortly. I think you might as well discuss them.

Senator MCCUMBER. I think they are the basis of your rates.

Dr. ADAMS. They are.

The CHAIRMAN. That is page 45?

Dr. ADAMS. Yes.

"(c) In the case of a single person, a personal exemption of $1,000; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,500, unless the net income is in excess of $5,000, in which case the personal exemption shall be $2,000."

Senator SMOOT. I move that we disagree to the House amendment.

Senator MCCUMBER. There are two things in connection with that that I would like to hear about from Mr. McCoy. The first is the question of what we lose by changing these exemptions as provided in this subdivision.

Mr. MCCOY. The additional exemption of $500 for the head of the family is limited here; that is to say, some will get it by reason of being the heads of families, and some will not, dependent upon the size of the income. The idea of the House committee was that the higher surtax brackets had been reduced, and it was claimed that that would help the wealthier people. They wanted to find some way of helping people in moderate circumstances, and this was one of their methods. They gave an additional $500 exemption to the head of a

family if the total salary did not exceed $5,000. That would mean a loss in revenue to the Government of about $40,000,000.

Senator SMOOT. If we reduce each one of these brackets 1 per cent, that will help. I would much prefer to do it than to have the exemption of $2,500.

Dr. ADAMS. Keep in mind, Senator, that that does not help the same class. It helps another class.

Senator SMOOT. It helps every class.

Dr. ADAMS. If you reduce the surtax, you affect the incomes from $5,000 up; if you reduce this, it has its effect upon incomes under $5,000.

Senator SMOOT. In other words, if a man has an income of $7,500, under the present law there would be a deduction or exemption of $2,000; if, however, the House provision is adopted, he would have an exemption of $2,500.

Dr. ADAMS. It should be noted that you are dealing with two different classes of people. The House provision gives an additional exemption of $2,500 to a class of people whose income is under $5,000. Mr. McCoy's scheme affects only persons having an income in excess of $5,000.

Senator MCCUMBER. Perhaps my views are peculiar to myself and will not be agreed to by others, but I have a general idea that every married citizen of the United States ought to pay a little tax—enough to know that he is a citizen and part of the paying public. I would have it very low on small incomes, but I would have a little something for anyone who had an income over $1,000 a year, even if it were not more than one-half or one-quarter of a per cent. If I had my way, I would commence with one-half or one-quarter of a per cent rather than 1 per cent on the very low incomes. Then I would not make such exemptions as you are making. There is some abuse of the exemption privilege of so much for every child, etc. I know of families where three or four members of the family are earning good wages and yet the percentage of tax that is paid is small. The head of the family may be getting $6,000 or $7,000 a year. He puts in all his children, if they happen to be under 21 years of age. Perhaps three or four of them may be earning good salaries. They are not paying on their salaries, and there is an immense number of people running close to that line. Of course, if you make it so little, you may say that it does not pay the expenses of collection, but I really believe we would get a lot more money if we made a smaller rate—half or a quarter per cent—until people begin to reach a point where they have considerable incomes.

The CHAIRMAN. Would you mind, Senator McCumber, if we get Mr. McCoy's opinion?

Senator MCCUMBER. Certainly not.

Mr. MCCOY. Senator McCumber has stated that the age limit was 21; the limit is 18 years. The children must be dependent. If they are earning incomes for themselves, those earnings are included in the family income.

Senator MCCUMBER. I guarantee that in 99 cases out of 100 they never make a return of their children's income. You would have to look at the returns with a fine-tooth comb to find if the parents were really making returns on the children's incomes.

Mr. MCCOY. My opinion is that 2 and 2 make 4 and that, therefore, two single persons getting married should not have more exemption than two persons who remain single. The exemption for the child is not much.

Senator WATSON. If we were making this bill from the ground up—and of course, we all realize that we are not—I would agree with Senator McCumber, but inasmuch as this is not that kind of a bill, I think it is a mistake to remove all the excess-profits taxes and repeal the higher surtaxes on personal income and then decline to make any of these increases in the exemptions in question. For that reason, I am going to vote against Senator Smoot's motion. I do not think it is wise policy.

Senator MCCUMBER. I do not think it would make it any harder, and I think it might be better to make less rates on these incomes. I would say a half per cent or a quarter of 1 per cent.

Senator MCLEAN. How much money will we lose under this?

Senator SMOOT. The $500 exemption means a loss of $40,000,000.

Senator MCLEAN. I was wondering how much it will net under the amendment?

Senator CURTIS. $40,000,000, I think he said.

Mr. MCCOY. There are 3,000,000 people whose incomes are between $2,000 and $5,000; there are 2,300,000 taxpayers, not heads of families, between $1,000 and $2,000; there are 3,000,000 heads of families between $1,000 and

$2,000 who pay no tax. Now, if you go from the $500 class to the $1,000 class, you strike out one-half that are not paying tax.

Senator SMOOT. I do not think it will hurt anybody in the United States to pay $10 per year.

Senator SIMMONS. How much do we lose by this additional exemption?

Mr. MCCOY. $40,000,000.

Senator SIMMONS. And if we cut the surtax as is proposed, there will be a loss of $95,000,000?

Mr. MCCOY. Down to 32 per cent, it will be $90,000,000.

Senator MCLEAN. We are losing $40,000,000 on this exemption?

Dr. ADAMS. The question is how much tax is paid by taxpayers having incomes of less than $5,000.

Mr. MCCOY. I have the figures for the normal tax here. There is $5,000,000,000 taxable at 4 per cent; that is about $200,000,000.

Senator MCLEAN. That includes single persons?

Mr. MCCOY. That includes everybody from $2,000 to $5,000.

Senator MCLEAN. What proportion of that would be paid by single persons?

Mr. MCCOY. A little over 1,000,000 people would pay, and the tax would be about $40,000,000.

Senator WALSH. I have a memorandum which says that in 1918 the number of returns between $1,000 and $2,000 was 1,032,000, and the normal taxes collected in 1918 amounted to $26,481,000.

Mr. MCCOY. The higher incomes come down into the lower brackets. There are more in that bracket. So it would probably run into $40,000,000. That is the estimate for 1922.

Senator MCLEAN. You are not getting much out of the single men.

Dr. ADAMS. In 1918 the tax paid by the class under $5,000 was $144,000,000. You will have to change that, Mr. McCoy.

Mr. MCCOY. About $200,000,000. There is more than that now.

Senator MCLEAN. Less than $30,000,000 of that comes out of single persons.

Senator CALDER. This exemption would mean a loss of how much?

Mr. MCCOY. $40,000,000.

Dr. ADAMS. If you will settle this question now, it will help a great deal. I realize that it takes time.

The CHAIRMAN. I should prefer very much to settle it now.

Senator SMOOT. My motion is that we disagree to the House amendment increasing the personal exemption from $2,000 to $2,500, so that it will remain as it is to-day.

The CHAIRMAN. What is the sense of the committee?

(After voting.)

The motion is lost, the vote being 10 to 3.

Dr. ADAMS. The related question is that of $400 for each child.

Senator SMOOT. I move that we disagree to the House amendment increasing the exemption from $200 to $400.

Senator WATSON. Let us find out first about the revenue.

Senator SMOOT. There is $30,000,000.

The CHAIRMAN. The motion is not agreed to.

I assume that the committee concurs in the House provision in both paragraphs—that is, as to the exemption of $2,500 and of $400, unless the committee wants to increase it or split it. In the absence of any motion, the assumption will be that the committee agrees to it.

Senator MCCUMBER. I want it understood that while I am staying with the committee on that proposition—on the question of exemption of the head of the family being increased—I do not think it should be increased for each child.

Senator CALDER. Mr. Chairman, I expect to have to leave the city for two days. During my absence, if any important vote comes up, I wish to leave my vote with the chairman and vote with the majority.

Senator CURTIS. Dr. Adams, is there any question that you want us to settle at this time?

Senator MCLEAN. It seems to me it would help Dr. Adams if he knew whether we were going to decide the excess-profits tax question finally or not.

The CHAIRMAN. Shall we vote on that now?

The question is, Is it the sense of the committee that the excess-profits tax shall be repealed as of January 1, 1921?

Senator SMOOT. That is the House amendment?

Senator LA FOLLETTE. No.

The CHAIRMAN. Does anyone wish to offer an amendment?

Senator SMOOT. The House provides that it shall be repealed in 1922.

Senator DILLINGHAM. I think we should not pass on that to-day. There are several things coming up that lead to some thinking on that question. There are a great many things to be taken into consideration in connection with that matter. I am in favor of the repeal, but I am much in doubt as to whether it should be effective as of last January or the next January.

The CHAIRMAN. Very well; it need not be voted on now.

Senator CALDER. Would not the question of the 15 per cent tax on corporations go with this? I voted for a 15 per cent flat tax on the income of corporations for this year. If this excess-profits-tax scheme should not be adopted, I shall have to move to reconsider the thing and go back and present a method of levying taxes for this year. I am strongly inclined to think that we will get more money for the Treasury through the 15 per cent tax.

Senator MCCUMBER. Let us have Mr. McCoy's statement.

Mr. MCCOY. The loss would be $200,000,000.

Senator SIMMONS. Do you mean to say that we would collect $200,000,000 more by keeping the excess-profits tax as it is now?

Mr. MCCOY. And the 10 per cent corporation income tax.

Senator CALDER. I am speaking of the 15 per cent tax.

Mr. MCCOY. As compared with the 15 per cent.

Senator CALDER. As compared with the 15 per cent direct tax upon incomes?

Mr. MCCOY. Yes.

Senator SIMMONS. This is what you mean: If we should now repeal the excess profits tax, effective January 1, 1921, and raise the tax on corporations from 10 per cent to 15 per cent, beginning January 1, 1921, the loss would be $200,000,000?

Mr. MCCOY. Close to $200,000,000.

Senator LAFOLLETTE. In other words, we lose about $450,000,000 by repealing the excess-profits tax and gain about $250,000,000 by imposing the increased corporation tax.

Mr. MCCOY. That is right.

Dr. ADAMS. Mr. McCoy's figures were $450,000,000 and $266,000,000, making a loss of about $184,000,000.

As to this particular amendment, if you should change your minds later in regard to it, it will necessitate many different changes in the bill. When you settle this question I wish you would settle it finally, because we can not draft the bill until we know.

Senator LAFOLLETTE. Are not all these changes you make in the individual income affected also by what we may do with respect to the excess-profits tax?

Dr. ADAMS. You can do what you please with the surtaxes; you may change your mind ten minutes before the bill is reported, but as to the excess profits tax, so many other questions depend on that that it should be settled finally.

The CHAIRMAN. In view of Dr. Adams's statement, suppose we have a unanimous-consent agreement to vote on this excess-profits tax at 10.30 o'clock to-morrow morning? If there is no objection, that will be considered the order.

(Thereupon, at 1.30 o'clock p. m., the committee adjourned until to-morrow, September 13, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

TUESDAY, SEPTEMBER 13, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Sutherland, Gerry, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. J. S. McCoy, actuary, Treasury Department; and Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives.

The CHAIRMAN. The committee will be in order, and I presume the first matter before the committee will be the vote on the excess-profits item.

Senator LA FOLLETTE. I wish Mr. McCoy would state again the proposition about the excess-profits tax and the reason why he is in favor of it.

Mr. MCCOY. I can not say I am really for it. When the receipts of the country fall very much and the revenue is required, it falls down; that is the only reason I have for omitting it.

But my reason for the elimination to January, 1922, instead of January, 1921, is something of policy. You can not convince the people that this tax has not been passed on for some nine months by the manufacturers. Now, if you eliminate it, who will benefit. The people will not benefit; it will be the manufacturers.

The CHAIRMAN. Has it not been passed on quite largely?

Mr. MCCOY. It has.

Senator LA FOLLETTE. By the manufacturers, and the retailers in particular.

Mr. MCCOY. Certainly. The manufacturers—the large concerns—will not pay much tax, but the retailers who are making more profit than heretofore, because they get their things from the manufacturers cheaper and sell them at practically the same price.

(The motion on agreeing to the House provision repealing the excess-profits tax as of 1922 was carried by the vote of 5 to 2.)

The CHAIRMAN. We will now receive the 20 or 30 amendments in their due order referred to yesterday as hinging on our action on this main point.

Senator SMOOT. I want to ask if Mr. McCoy has his brackets made out for the income tax and the information that was asked for?

Dr. ADAMS. Do you gentlemen want to take up now or later the question of the corporation rate? I assume this year it would be 10 per cent. The question is what rate should go into effect January, 1922.

The CHAIRMAN. That is a question, is it not, of how you are going to raise your revenue?

Dr. ADAMS. That is the point.

The CHAIRMAN. You and Mr. McCoy are the authorities.

Dr. ADAMS. The figures show plainly that we are really more in need for the calendar year 1922 and the fiscal year 1923. If you will consult the figures you have, you will see we figured on a close basis for meeting our estimated expenditures for the fiscal year 1922—I do not want to say "comfortably," but safely—but we are falling short, if anything, for the calendar year 1922 and the fiscal year 1923. In other words, we need more revenue, in my opinion,

in the calendar year 1922 and the fiscal year 1923 than we will need for the fiscal year 1922.

Senator WATSON. Do you mean by that not on account of increased expenditures but on account of obligations falling due?

Dr. ADAMS. In the first place, the fiscal year's receipts are greatly increased this year by the fact that two of the payments are installments of income and excess-profits tax based upon the much higher income for 1920. The excess-profits tax for the fiscal year 1920 is calculated to yield $669,000,000. The income tax is yielding more revenue by reason of the fact that two of the installments collected in the fiscal year 1922 are based on the 1920 income. Again, you will provide for the abolition and repeal of some or all of the transportation taxes to take effect January 1, 1922. Whatever reduction there is will only count on one-half of the fiscal year, but in the calendar year it will count, and for the calendar year 1922 and the fiscal year 1923 it will count in full.

The CHAIRMAN. Is not the point to be considered whether it is wise to depart from a time-honored tax like the transportation tax and then increase some other tax? Is that good policy? You can tell the public, of course, they are paying 50 per cent less on transportation, but, on the other hand, you are raising your corporate income tax perhaps.

Dr. ADAMS. You are abolishing the excess-profits tax, and I assume if you abolish the excess-profits tax you would also abolish for the year 1922 the capital stock tax. Those are great considerations. The capital stock tax, while at a low rate, is one of the most unsatisfactory taxes we have.

Senator WATSON. I recall it produces $80,000,000.

Dr. ADAMS. It produces $80,000,000, and it leads to constant bickerings and tax disputes, allows a very wide latitude of judgment, and in my opinion corporations would be decidedly better off with the 15 per cent income-tax rate and no capital-stock tax because of the trouble involved in its determination and payment, and the fact that the capital-stock tax falls on the corporation whether or not it is earning any money.

The CHAIRMAN. Can we put the two questions together?

Dr. ADAMS. That would be a natural and proper way to put it; the two go together.

Senator SMOOT. The real estate corporations of this country feel they are discriminated against, that they are struggling to build buildings, and that this tax of 15 per cent is a burden upon them.

The CHAIRMAN. Is it the sense of the committee that the capital-stock tax shall be abolished and the corporate income tax be made 15 per cent?

Senator LA FOLLETTE. May I just ask a question?

The CHAIRMAN. Certainly.

Senator LA FOLLETTE. What is the net gain in revenue, in your opinion, by that?

Dr. ADAMS. Two and one-half per cent would yield $110,000,000, and the capital-stock tax $80,000,0.

Senator LA FOLLETTE. So it is a gain?

Dr. ADAMS. It is a gain.

Senator SMOOT. Doctor, that is wrong.

Dr. ADAMS. From the 2½?

Senator SMOOT. From the 5.

Dr. ADAMS. The extra 2½ would be, I should think, about $110,000,000 and the capital-stock tax is $80,000,000. I will ask Mr. McCoy to check that figure of $110,000,000.

Mr. MCCOY. It would be a gain of $70,000,000.

Dr. ADAMS. I was thinking that over against the 10 per cent that the committee has decided upon probably it would adopt the 2½ rate anyhow. Suppose we put on additional 2½ per cent and take off the $80,000,000 it would not be quite $156,000,000.

Mr. MCCOY. That would be $187,000,000 net gain.

Senator WALSH. I understand Mr. McCoy to say we would lose $45,000,000 a year?

Mr. MCCOY. Yes, sir.

Senator WALSH. I would like to ask him how much more we would have to make up from other sources than corporations if we now repeal the corporation capital stock and increase the corporation income tax to 15 per cent?

Mr. McCoy. I would have to know how much we need.

Senator Walsh. Suppose we have disposed of $450,000,000—canceled that obligation in excess-profits tax. If we vote to repeal the capital stock we lose $80,000,000, and if we vote to increase the corporation income tax to 15 per cent, how much will we have to raise to offset these losses, in other directions?

Mr. McCoy. To get the same revenue, $263,000,000.

Senator McCumber. We would be short?

Mr. McCoy. Yes.

Senator Dillingham. The tax was put on during the Spanish War.

Senator Walsh. Is it a fact that in repealing the excess-profits tax and increasing the corporation-income tax that it is bound to result in certain corporations being relieved of the heavy taxation they would have to pay in excess-profits taxes and the smaller corporations that have never paid having their taxes increased?

Dr. Adams. I think that is not a fact, personally.

Senator McCumber. The result would be just the opposite, according to the testimony.

Senator Walsh. Then have you considered at all a graduated corporation income tax commencing at 10 per cent and going to 20 per cent, fixing the tax along certain brackets of income?

Dr. Adams. I do not know what the Secretary has considered. I have considered many times the question of a graduated tax, and it seems to me rather obviously inapplicable, because you can not tell how many stockholders are interested. There may be a very large corporation, the stockholders of which are rather small men, of rather small means; there may be, vice versa, a small corporation the stockholders of which are very important men, of large means. So that the ordinary principle would be pretty plainly not applicable to corporations.

Some other kind of a progression may be tried.

Senator Walsh. You have in mind that the Government will gain from the loss in excess profits through its tax upon individuals?

Dr. Adams. You are speaking of the excess-profits tax?

Senator Walsh. Yes; the repeal of the excess-profits tax and the increase of the income tax from 10 to 15 per cent. It means a lowering of the tax burdens of corporations that make big profits and increasing the tax on the profits of the smaller, weaker, and poorer corporations. You dispute that?

Dr. Adams. The sole point with respect to that is this: The basis of the tax is so imperfect that I do not think that you can get a fair measure of the rate of profit.

Senator Walsh. Is there anything in the contention the real estate people make? I think Senator Smoot agrees with the contention. The result, they say, is that we are going to lift the tax burden off of the profiteering operations and put an increase tax upon the class of corporations that have not made a reasonable profit?

Dr. Adams. That would be a fair statement and an unanswerable statement, sir, if the excess-profits tax worked out the way it was intended to work. But such results were not secured.

Senator Smoot. I agree with Dr. Adams. Their contention is this, and I suppose it is rather right, that under the excess-profits tax they are not compelled to pay any tax, but under this provision they would be compelled to pay a tax.

Senator Walsh. The excess-profits tax paying more than 15 per cent is reduced to 15. So that, however, it may be argued that it does not put a burden upon a certain class of corporations and reduce the burden, I can not understand.

Dr. Adams. Let me explain.

Senator Walsh. I mean, as a class.

Dr. Adams. You must look at it as a class. I agree with that. But take a real estate corporation that has bought its real estate at a low figure a good many years in the past. Many of them are in that category. Whatever the property may have been worth on the 1st of March, 1913, whatever it may be worth to-day, whatever it has come to be worth, whatever the present stockholders paid for their stock, none of those things count. The tax may be very high because the property was bought very low.

I will tell you about two real estate corporations to illustrate this. They are not suburban companies, but timber-holding companies which possessed two

tracts of timberland acquired in 1898, as I recall, each of them costing a little less than $500,000. They were acquired by a set of interests in Milwaukee. In fact, they were acquired by the same small group of men originally. One of them was recapitalized and reorganized in 1907, because they were offered for their property $3,500 000. They recapitalized, expecting to sell. They, however, did not sell. I should say also that there was a mill put up on one property while there was not on the other, and to that extent it became different. However, the offer they received would net about $3,000,000 for their real estate.

The other company had not, the last time I knew anything of it, recapitalized. Its capital stood on the books at $480,000, plus taxes.

Those two companies would come under the excess-profits tax, and one would have its profits computed on a basis of $480,000 and the other on substantially $3,500 000, and the only difference is that a mill costing a little over $500,000 had been put on one property and had not been put on the other.

Senator WALSH. I have not in mind that class of real estate. I have in mind the kind of real estate companies that exist in Boston, New York, and Chicago, which do not overcapitalize but which invest their money in these corporations and build large buildings in our cities, and they are not paying any return worth while. I think the average of these real estate holdings in Boston is less than 2 per cent.

Dr. ADAMS. There are very legitimate corporations that would be affected, but almost none that take into account the exemption from capital stock tax. They feel the capital-stock tax with particular severity, they have large capital, and that is why they have large values. Those are the kind, which, whether earning money or losing money, have the capital-stock tax to pay.

(The question of abolishing the capital-stock tax and making the income tax of 15 per cent apply to 1922 was carried by vote of 6 to 2.)

Dr. ADAMS. The Secretary asked you for $3,200,000,000 for the fiscal year 1922; that is, this fiscal year.

Mr. McCoy's estimate for the yield of the House bill, as modified by the Secretary's suggestions, was, for the calendar year 1922, $2,700,000,000. That was approximately $500,000,000 short of the $3,200,000,000, but it was assumed that we would not spend as much money in the calendar year.

Senator SMOOT. He says $500,000,000 less.

Dr. ADAMS. The question is what the expenditures will be for the calendar year. We have no estimates and they must be roughly approximated.

I do not think that this item of $495,000,000 for the railroads is involved or contained in it at all. We are going to sell those securities to meet further and other payments or advances. If it is changed, it ought to be changed in the way of increase and not in the way of reduction.

Senator WATSON. Why do we have so much contention about the fiscal year and calendar year?

Dr. ADAMS. The most productive taxes, the income and profits taxes, vary chiefly from calendar year to calendar year owing to changes in rates and so on. But the expenditures of the Government vary from fiscal year to fiscal year, ending June 30. It is as confusing as can be, but I do not see how we can get rid of it.

Senator WATSON. Do I understand that for the calendar year 1923 we will have need of $2,700,000,000?

Dr. ADAMS. That was what the House bill would yield, as amended by the Secretary's recommendations.

Senator WATSON. Do our changes increase it?

Dr. ADAMS. They do.

Senator MCLEAN. How much will the increases we are making here amount to?

Dr. ADAMS. The increase that you have made by adopting the 15 per cent instead of the 12½ per cent rate is a matter of some dispute. Mr. McCoy, how much gain will we get by that extra 2½ per cent over the loss of $80,000,000 due to the capital stock tax repeal?

Mr. MCCOY. I have estimates for the fiscal year 1923 and for the calendar year.

(The estimates referred to and submitted by Mr. McCoy are here printed in full, as follows:)

Estimated revenues under H. R. 8245 as passed by the House and as amended in accordance with the suggestions of the Secretary of the Treasury for the fiscal year 1922 and the calendar year 1922.

	Estimated revenue.			
	Fiscal year 1922.		Calendar year 1922.	
Losses from House bill:				
Profits tax		$250,000,000	$450,000,000	
Capital stock tax		.....	60,000,000	
Total loss		250,000,000		$510,000,000
Gains from House bill:				
Corporation tax	$160,500,000		267,500,000	
Transportation	65,500,000		131,000,000	
Insurance	5,000,000		10,000,000	
Perfumery, cosmetics, and proprietary medicines	3,000,000		6,000,000	
Total gains		234,000,000		414,500,000
Net loss		16,000,000		95,500,000

	Estimated revenue.			
	Fiscal year 1922.		Calendar year 1922.	
	H. R. 8245 as passed House.	H. R. 8245 as proposed.	H. R. 8245 as passed House.	H. R. 8245 as proposed.
Income tax:				
Personal	$800,000,000	$800,000,000	$750,000,000	$750,000,000
Corporation	450,000,000	610,500,000	400,000,000	667,500,000
Profits tax	669,000,000	419,000,000	450,000,000	.....
Miscellaneous	1,160,455,000	1,233,955,000	981,290,000	1,068,290,000
Back taxes	235,000,000	235,000,000	300,000,000	300,000,000
Total	3,314,455,000	3,298,455,000	2,881,290,000	2,785,790,000

Estimated revenues under H. R. 8245 as passed by the House and as amended in accordance with the suggestions of the Secretary of the Treasury for the fiscal year 1923 and the calendar year 1923.

	Estimated revenue.			
	Fiscal year 1923.		Calendar year 1923.	
Losses from House bill:				
Surtax reduction		$40,000,000		$70,000,000
Profits tax		200,000,000		.....
Capital stock tax		80,000,000		80,000,000
Total losses		320,000,000		150,000,000
Gains from House bill:				
Corporation tax	$190,000,000		$140,000,000	
Transportation taxes	65,500,000		.....	
Insurance	5,000,000		.....	
Perfumery, cosmetics, and proprietary medicines	6,000,000		6,000,000	
Total gains		266,500,000		146,000,000
Net loss		53,500,000		4,000,000

Estimated revenues under H. R. 8245 as passed by the House and as amended in accordance with the suggestions of the Secretary of the Treasury for the fiscal year 1923 and the calendar year 1923—Continued.

	Estimated revenue.			
	Fiscal year 1923.		Calendar year 1923.	
	H. R. 8245 as passed House.	H. R. 8245 as proposed.	H. R. 8245 as passed House.	H. R. 8245 as proposed.
Income tax:				
Personal	$750,000,000	$710,000,000	$750,000,000	$690,000,000
Corporation	490,000,000	680,000,000	560,000,000	700,000,000
Profits tax	200,000,000			
Miscellaneous internal revenue	988,330,000	984,830,000	995,270,000	921,270,000
Back taxes	320,000,000	320,000,000	340,000,000	340,000,000
Total	2,748,330,000	2,694,830,000	2,645,270,000	2,641,270,000

Mr. McCoy. It is estimated that the revenue, eliminating the capital-stock tax and having a 15 per cent corporation tax in lieu of the profits tax, will give a net decrease for the calendar year of $150,000,000 and the increase $146,000,000; that is, there is a further surtax reduction that will not enter here. It was a 25 per cent reduction. The losses over the House bill for the calendar year 1923 will only be $800,000,000 of capital stock. The gains will be $140,000,000 of corporation tax, $6,000,000 from the proprietary medicines and cosmetics, making a total gain of $146,000,000 as opposed to the total loss of $80,000,000. You have voted to make a maximum surtax of 32 per cent, while this was prepared on the basis of 25 per cent. So you gain $66,000,000 over the House bill for 1923.

The Chairman. Mr. McCoy, when you stated a moment ago that we would raise enough revenue, what did that mean would be done with the transportation tax?

Mr. McCoy. It would be cut in half.

Senator Smoot. I would like to have the transportation tax go out.

The Chairman. We have not voted on that. Mr. McCoy, what is the status of the candy tax?

Mr. McCoy. It is cut from 5 to 3 per cent.

The Chairman. How much revenue do we lose?

Mr. McCoy. About fourteen or fifteen million dollars.

Senator Curtis. Why not put the candy tax back?

Senator Simmons. How much do we get from the tax?

Senator Smoot. You gain $8,400,000.

The Chairman. Let us go on. What is next, Dr. Adams?

Dr. Adams. Shall we take up these various items?

Senator Dillingham. We were trying to hear what Mr. McCoy had to say, but none of us was able to hear him.

Mr. McCoy. My idea of the question was as to the sufficiency of the revenue. The way it stands now, for the fiscal year 1922 we have sufficient; for the fiscal year 1923, we will collect, in round figures, $2,740,000,000. If the railroads should fall off $500,000,000 for the fiscal year 1923, it would still leave us $3,200,000,000 to meet all the current expenditures. That seemingly would be sufficient.

Senator Walsh. You mean if we adopt the House provision?

Mr. McCoy. As amended by the committee.

The Chairman. I cease to disturb my mind about anything more than $3,200,000,000.

Senator Simmons. Does that include the tax on transportation; that is, one-half of the amount?

Mr. McCoy. Just for the year 1922. Half of that will be in the fiscal year 1923. For the year 1922 the tax is cut in half, and at the end of the year is done away with entirely.

Senator Simmons. In your calculations for 1922 you have included one-half of the present transportation tax?

Mr. McCoy. Yes; and for the fiscal year 1923 there is one-quarter—$65,000,000.

The Chairman. Let us make note of that and vote on it when the time comes. Dr. Adams, will you proceed.

Dr. Adams The next amendment I have is on page 30, line 12. The suggested amendment relates to community incomes. In order to prevent misunderstanding, it is suggested that the word "marital" be included, making it read: "Income received by any marital community." That is on page 30, line 12, after the word "any."

Senator Simmons. I think that has a clarifying effect. I had to study that a long time to decide what it meant.

The Chairman. If there is no objection, that amendment will be agreed to. Proceed Dr. Adams.

Senator Curtis. It seems to me you ought to put in the word "such," making it read "such community property."

Dr. Adams. Strike out, on page 30, line 15, the period and insert in lieu thereof the following: "And shall be taxed as the income of such spouse."

The Chairman. If there is no objection, it will be agreed to.

Dr. Adams. The next amendment in the present law is at line 24, where you strike out "to individual beneficiaries or to the estate of the insured." That is to permit the corporations which are insuring the lives of officials or employees on the death of the employees to take the insurance without the taxation. It is now taxable.

Senator La Follette. What is the reason for that, and how much revenue does it lose?

Dr. Adams. I think it is trivial. I do not know that anyone could possibly estimate it correctly. If an individual insures his life and he dies, nothing is taxed. If a partnership insures the life of an employee and the employee dies, the partnership receives the insurance and nothing is taxed. If a corporation insures the life of an employee there is a difference. The corporation pays a tax on the difference between the premium paid and the amount received. Employees are not insured by corporations unless the death of the employee or employees would mean a real loss to the corporation.

The Chairman. Are they not compelled by law in some States to do it?

Dr. Adams. That is compensation insurance. This is life insurance, where employees are necessary to the corporation. The corporation is allowed no deduction for the premium it pays, so that there is almost an inevitable and real loss to them. There seems to be no reason why the proceeds should be taxed. That is the thought underlying it, plus the question of ceasing to discriminate in favor of the individual and the partnership as against the corporation.

The Chairman. If there is no objection, it will be agreed to.

Dr. Adams. The next change is in line 21, on page 31. After the words "United States" insert a comma and the following: "other than postal-savings certificates of deposit," so that it will read:

"In the case of obligations of the United States, other than postal-savings certificates of deposit, and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective acts authorizing the issue thereof as amended and supplemented."

At the present time we are taxing such interest.

The Chairman. If there is no objection, it will be agreed to.

Senator Walsh. Dr. Adams, isn't this the place where the question of who makes the returns comes in?

Dr. Adams. No; this is the place where we have the tax on postal-savings certificates.

Senator Walsh. I thought that this was the place.

Dr. Adams. No; I have an amendment on that.

Senator Smoot. The amendment on page 31, line 14, down to and including line 21, went over temporarily. We want statistical information. That was to be discussed and decided upon.

Dr. Adams. Oh, pardon me. Lines 15 to 21 wipe out the requirement that the taxpayer shall state in his return the tax-free obligations which he possesses, showing the number and amount of such obligations—securities and bonds—owned by him and the income received therefrom.

The Chairman. What is the pleasure of the committee? Is the committee ready to vote? It has been discussed thoroughly.

Senator Curtis. The only way to get that question before us would be for some one to offer an amendment. It is already stricken out of the House bill.

The CHAIRMAN. We can vote on a motion to put it back or agree to the House amendment. That would meet parliamentary requirements.

Senator WALSH. Just a moment. Is there any provision in existing law requiring the taxpayer to give a list of nontaxable securities which he holds?

Dr. ADAMS. This is the law.

Senator WALSH. We are now striking it out. I think that is a serious matter. I think there are few, if any, questions so important as the question of the tax-exempt securities.

The CHAIRMAN. Will you permit me, Senator Walsh, to make a suggestion? We discussed this for a couple of hours the other day. Its pedigree has been gone into, and the committee understands that phase of it thoroughly.

Senator WALSH. I think there was a division of opinion.

The CHAIRMAN. That may be.

Senator WALSH. If there was a division of opinion, I think the matter ought to be discussed. It would be helpful in determining to what extent our money is going into productive sources and into nontaxable securities. People are investing their funds so as to be able to report them as tax-exempt securities.

The CHAIRMAN. A large number is held by trust companies and estates and tax evaders.

Senator MCCUMBER. Dr. Adams says there is such a large proportion of them holding these bonds and tax-free certificates that we would get no information that would be of particular value.

The CHAIRMAN. A large number is held in small amounts.

Dr. ADAMS. I canvassed the situation, at the request of Senator La Follette.

The CHAIRMAN. I put this in.

Dr ADAMS Yes; Senator Penrose had this put in. The information which we are getting is so imperfect that the department feels that it is not worth the trouble of getting it.

Senator WALSH. Because the people do not make the returns?

Dr. ADAMS. I could cite a number of reasons. Even if it is kept, some of the unnecessary details should be omitted. The clerical labor involved explains some of its defects.

Senator LA FOLLETTE. Would it not be possible to redraft the provision in such way as to make it effective and at the same time simplify the administrative features of it? If you say yes to that, then I would suggest that we pass it over for the present so that we can work it out.

Dr. ADAMS. Do you want us to do that, Senator, when you know that when we get through it is going to be limited to a group. I do not think the figures will be accurate enough to satisfy you. In other words, Mr. McCoy's calculation would be a more accurate statement of the picture than you would get from these returns. That is the sole point.

Senator LA FOLLETTE. Can't this be revised so as to get the information?

Dr. ADAMS. If we call upon corporations and persons whether or not they are making returns, to do this, you have yet to deal with the constitutional phase of it. A well known lawyer—I do not wish to mention his name—advised his clients that this was unconstitutional, and a great many people have refrained from making returns on that account. When we get the detailed estimate made by simply taking the amount of outstanding bonds that we know from Treasury Department figures are outstanding, won't that answer your query better than what you have in mind?

Senator SMOOT. I want that information so that we may have it for consideration in connection with the repeal of the exemption, that is, in the repeal of the free tax-exempt bonds issued by the States, and other matters. I thought this, that there were so many that bought these 3½ per cent Liberty bonds, and only bought one bond, that we might be able to get at that. I do not know how we would get at it.

Senator MCLEAN. Why not limit the amount in excess of $5,000. Wouldn't it be more practicable and wouldn't it be likely to bring more satisfactory results? What we want is to uncover sequestered large fortunes. I do not think we care much about the man who has $2,000 invested in tax-free securities.

Senator WATSON. Suppose we find out that large fortunes are sequestered. What good will it do?

Senator MCLEAN. I would require that they be given to the public, just for the moral effect.

Senator WATSON. You can not compel money to come out of hiding—money paid for tax-free securities—and have it invested in railroad securities.

Dr. ADAMS. The question is this: Do you want to deal with the details of the various issues or do you want the amount of interest collected?

The CHAIRMAN. Do you want it passed over, Senator La Follette?

Senator LA FOLLETTE. I do not know.

The CHAIRMAN. It has been very thoroughly discussed. It has been talked over for three years.

Senator LA FOLLETTE. The only thing to vote upon is whether we will retain this imperfect provision. My thought is that possibly a provision might be drafted that would be worth the consideration of the committee.

Senator MCCUMBER. I wish that we could get information in reliable form. I have asked the experts three or four times if they could get for me anything to verify the claims made that people of large incomes, instead of putting their money in business, are putting it in tax-free securities. They do it because they can make more money, it is said, by putting it in tax-free securities. But there seems to be nothing to substantiate these statements.

Dr. ADAMS. We have a published paper here.

Senator MCCUMBER. But we have no specific data that they are doing that.

Senator SIMMONS. Why not vote on it? If something better is offered, we can take that up later.

The CHAIRMAN. What is the pleasure of the committee? [After a vote.] It seems to be agreed to—the way the House has amended it—with the understanding that we can change our minds on the floor of the Senate or at any time.

What is the next item, Dr. Adams?

Dr. ADAMS. A change on page 29 and the top of page 30. The amendment offered is to strike out the provision imposing a tax on the President of the United States, the judges of the Supreme Court, and inferior courts of the United States, and so on.

You will have another provision stating that the salaries of the President of the United States and of the judges of the Supreme Court are exempt.

The CHAIRMAN. I move that they be exempted from tax, as the House has indicated.

Dr. ADAMS. May I say a word? The present House bill says nothing about the judges of the District of Columbia or of possessions of the United States. If Federal judges are exempted, and State judges are already exempted by the Constitution, the House bill would leave taxable the judges of the Supreme Court of the District of Columbia and of the various Territories. Do you want them isolated and left taxable while the others are exempt; do you want to tax them all, or do you want to exempt them all?

The CHAIRMAN. Is it the pleasure of the committee to concur in the House amendment with the further amendment suggested by Dr. Adams, making the exemption apply to the minor judiciary?

Senator MCCUMBER. I want to say here that I am against the exemption. I will vote upon it, but I want the pleasure of saying that I do not believe in exempting any of them.

Senator WATSON. Ordinarily I would not be in favor of these exemptions, but the President of the United States, when we come to think about it, is in a peculiar situation. In the first place, it is exceedingly expensive for him to live in the White House.

(Informal discussion followed.)

The CHAIRMAN. The question is on concurring in the House amendment regarding these exemptions, with a further similar amendment suggested by Dr. Adams. We will divide it in two, settling first the House provision as it stands. [After a vote.] The vote stands 7 to 5 against the proposition. The House amendment is not agreed to, and these officials are taxed on their salaries.

Dr. Adams's amendment is, therefore, unnecessary. The committee will now proceed.

Dr. ADAMS. The next amendment occurs at the top of page 32 and is purely a verbal change. It does not change the law at all.

The CHAIRMAN. What is next?

Dr. ADAMS. The next is on page 33, lines 11 to 15, striking out the exemption now granted persons in the military and naval forces of the United States on salary or compensation under $3,500. It is stricken out by the House, giving them no exemption.

The CHAIRMAN. That is on account of the war being over, I suppose.

Dr. ADAMS. Yes.

The CHAIRMAN. It is moved that the committee agree to the House amendment. If there is no objection, it will be considered as agreed to.

Dr. ADAMS. The next is subdivision 8, line 16, granting exemption to foreign shipping companies whose earnings from the United States consist exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grant an equivalent exemption to citizens of the United States and to corporations organized in the United States. The word "and" should be changed to "or."

Senator SMOOT. Aren't you going to have difficulty in allocating the taxes?

Dr. ADAMS. This is designed to create a general understanding between the maritime nations by which each ship will be taxed by its own country.

The CHAIRMAN. Who recommended that amendment?

Dr. ADAMS. Senator Jones has introduced an amendment to do this thing, but it is not quite so technically correct as this.

The CHAIRMAN. I remember that.

Dr. ADAMS. I changed it to this form.

The CHAIRMAN. It is not a matter of tremendous moment, is it?

Dr. ADAMS. It is a matter of some importance. There are a few shipping companies which will escape tax.

The CHAIRMAN. That is what I have in mind. I was thinking of the revenue.

Dr. ADAMS. It is a mixed question, but the Treasury Department decided it was a wise thing to do.

Senator DILLINGHAM. I move to concur.

Dr. ADAMS. Strike out the word "and" and change it to "or," in line 20.

The CHAIRMAN. That is agreed to.

Dr. ADAMS. No. 9 is next:

"Amounts received as compensation, family allotments, and allowances under the provisions of the war risk insurance and the vocational rehabilitation acts or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war."

Senator SMOOT. Then No. 10 goes out?

Dr. ADAMS. We haven't got to that yet. Do you want No. 9?

The CHAIRMAN. Pensions is new in No. 9?

Senator SMOOT. Let us see what this is.

The CHAIRMAN. Why not strike it out?

Dr. ADAMS. Exemption of pensions is new.

The CHAIRMAN. I say that is new.

Dr. ADAMS. Yes; it is new.

The CHAIRMAN. It is not a matter of great magnitude, is it?

Dr. ADAMS. Not at all.

The CHAIRMAN. Why should it go forth, then?

Dr. ADAMS. It was urged in the House—that is, these exemptions were urged.

Senator DILLINGHAM. I move that we concur.

The CHAIRMAN. It is concurred in.

Dr. ADAMS. No. 10 you have disagreed to.

The CHAIRMAN. That goes out.

Dr. ADAMS. The next is No. 11. That gives an exemption of $500 interest. It reads:

"So much of the amount received by an individual as dividends or interest on domestic building and loan associations, operated exclusively for the purpose of making loans to members, as does not exceed $500."

Senator SIMMONS. I think that is Senator Calder's.

The CHAIRMAN. A great body of building and loan people in Washington appeared before the Committee on Banking and Currency, of which Senator McLean, Senator Calder, and I are members.

Senator SIMMONS. The only purpose is to stimulate building through the borrowing of money from building and loan associations.

The CHAIRMAN. I notice it applies to loans to members for any purpose. It does not say loans for business purposes. It certainly ought to be amended to restrict it to building if it is kept in. If there is no objection, it will be stricken from the bill and seriously considered in the conference.

Dr. ADAMS. The next is subdivision (c). The House provision which is stricken out is not changed.

Senator SMOOT. There is a reference here to section 217.

Dr. ADAMS. That is repeating it. There is no substantial change there. The next is page 35, lines 5 to 7, giving deductions for traveling expenses, including the entire amount expended for meals and lodging, while away from home in the pursuit of a trade or business.

Senator LA FOLLETTE. What is that for?

Dr. ADAMS. That is for the traveling man. He is now required to make a troublesome report, and he gets only the difference between his home expenses and his expenses while abroad.

Senator MCCUMBER. His expenses abroad are now deducted?

Dr. ADAMS. No, sir.

Senator MCCUMBER. In other words, he has to state what his net profits are. How can you take out the net profits if it cost him so much to live abroad?

Dr. ADAMS. This is the case of the ordinary traveling man, who for a long time was not given a deduction for traveling expenses. He can now take the difference between what it costs him abroad and what it would cost if he stayed at home.

Senator MCCUMBER. There are two sides to that question. Take the case of a single man: If he stays at home he has to pay for his meals and lodging, but if he is on the road all the time you give him that much advantage over those who do have to support themselves.

The CHAIRMAN. You are getting down to pretty fine details now.

Senator MCCUMBER. I move to disagree with the House provision.

The CHAIRMAN. Senator McCumber moves not to concur in the House amendment.

The vote stands 5 to 3; it is agreed to. It will go into conference.

Dr. ADAMS. The next change occurs on page 35, lines 14, 15, and 16, and lines 18, 19, 20, 21, and 22.

Senator SMOOT. Back in line 7 on this page I find the words "including rentals." The House struck out "including."

Dr. ADAMS. I think that is a misprint.

Senator SMOOT. Just so that we understand it.

The CHAIRMAN. Proceed, Dr. Adams.

Dr. ADAMS. That will go back in this draft, because you have used the word "including" above.

Coming into paragraph 2, lines 14, 15, and 16, at the present time a person who borrows money to purchase or carry tax-free securities is not permitted to deduct the interest which he pays on that borrowed money, except that he is permitted to do so in case of obligations of the United States issued after September 24, 1917.

Senator MCCUMBER. Why then?

Dr. ADAMS. This was to help stimulate investment in Government bonds.

Senator SMOOT. Let it go over for a moment.

The CHAIRMAN. What is next?

Dr. ADAMS. Lines 18 to 22. That is the provision relating to the nonresident alien. That is covered in 217.

The CHAIRMAN. That is agreed to

Dr. ADAMS. The next provision occurs in line 23, or beginning at line 23. All of that is stricken out. Under the present provision there is no deduction for taxes paid.

That has been simplified in paragraph 3, page 36.

I know of no change except in phraseology.

Mr. BEAMAN. There is a necessary amendment in line 19. The words "allowed as a credit" are misplaced. The words "allowed as a credit" should modify "any of its possessions or of any foreign country" and not "the United States." The way it is written there it would give a deduction for income taxes in the United States.

The CHAIRMAN. We will rely on you to fix that, Mr. Beaman.

Dr. ADAMS. Page 37, lines 5 and 6. The present law is that in the case of a nonresident alien he gets only such loss as is sustained in connection with transactions within the United States. That is modified to read:

"But in the case of a nonresident alien individual or foreign trader only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under paragraphs (4) and (5) for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of the revenue act of 1921, where it appears that at or about the date of such sale or other disposition the taxpayer has acquired identical property in the same or substantially the same amount as the property sold or disposed of."

Senator MCLEAN. Did I understand you to say that there is another provision that takes care of the regular broker?

Dr. ADAMS. He is allowed to inventory that; but, as a matter of fact, I am going to suggest later on an appropriate place for that amendment.

Senator SIMMONS. Why do you say this is related to gifts? I thought all it related to was loss.

Dr. ADAMS. It does. But it started from the gifts proposition. It relates to any person who sells and buys back.

Senator MCLEAN. If it is sold to take a loss and bought right back?

Senator SMOOT. There are two great evils here. I think the lesser of the two is provided for in this amendment. I am going to vote for it.

The CHAIRMAN. What is the pleasure of the committee? [After a vote.] It is unanimously agreed to.

Dr. ADAMS. As to this provision, there is one change which might be helpful. Strike out, in line 12, after the word "that," the words "at or about," and insert in lieu thereof "30 days." A number of persons have complained that "at or about" is too indefinite. It would then read:

"Stock or securities sold after the passage of the revenue act of 1921 where it appears that within 30 days of such sale or other disposition the taxpayer has acquired identical property in the same, or substantially the same, amount as the property sold or disposed of."

The CHAIRMAN. Suppose the taxpayer has been away more than 30 days.

Dr. ADAMS. It should be made a definite rather than in indefinite proposition.

The CHAIRMAN. I do not care particularly how you make it, but a great many people will be away more than 30 days.

Senator MCCUMBER. Make it 60 days.

Senator SMOOT. They may be in another country.

The CHAIRMAN. Yes. It will be 60 days, if there is no objection.

Senator DILLINGHAM. There is objection. I think 30 days is long enough.

(After a vote.)

The CHAIRMAN. Thirty days is agreed to.

Dr. ADAMS. Page 37, line 13, after the word "acquired," insert, in parenthesis, "other than by gift, bequest, devise, or inheritance." It would then read:

"Where it appears that within thirty days of such sale or other disposition the taxpayer has acquired (other than by gift, bequest, devise, or inheritance), identical property in the same or substantially the same amount as the property sold or disposed of."

They may be received in these ways and should not be subject to this provision in such case. A man may dispose of stock, for instance, in the sale of a corporation, a bona-fide sale. Someone may will him identical shares within the 30-day period. The restrictions in this provision should not apply to such a case.

Senator SIMMONS. When you say "bequest or devise," I think it is all right, but when you say "gift," I think it is unwise.

Senator MCLEAN. You could change the word "acquire" to "purchase."

Dr. ADAMS. All right, Senator. The word "purchase" will take care of it.

The CHAIRMAN. If there is no objection, the provision is agreed to as amended.

Dr. ADAMS. The next changes are in lines 24 and 25:

"Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the commissioner, be accounted for as of a different period."

Senator Smoot, I think, was doubtful about that.

Senator SMOOT. That is as to oil impounded.

Dr. ADAMS. And similar cases.

Senator SMOOT. It involves similar cases. It does seem to me that you have wide discretion here.

Dr. ADAMS. I want to say very frankly that you are doing what Senator Smoot says—you are giving the department wide discretion. The administrative branch does not want it, because it makes us trouble. It was put in there to take care of some cases where great injustice was done.

Senator SMOOT. Don't you think there may be one case of injustice where there will be two that will be the other way?

Senator SIMMONS. I think we had better leave it to the discretion of the department.

Senator SMOOT. I would rather allow it to be done by regulation.

Dr. ADAMS. It can not be done by regulation. If it is not sustained that year it can not be taken at that time. The provision was inserted to give elasticity.

The CHAIRMAN. What is the sense of the committee? Is it agreed to? Is the amendment agreed to? [After a vote.] It is agreed to.

Dr. ADAMS. Lines 5 to 9, page 38:

"Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a bad debt is recoverable only in part, the commissioner may allow such debt to be charged off in part."

I want to ask, not finally, that you do not agree to that, but simply raise it in conference.

The CHAIRMAN. If there is no objection, the committee will not agree to the House provision now.

What next, Doctor?

Dr. ADAMS. I raise merely for your discussion at this point, on page 38, subsection (8), lines 10 to 12, the question of whether you desire to retain it or whether you want a substitute for that language. I say this because it has come up in the committee. It reads:

"A reasonable allowance for the exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

You may desire to insert the word "depreciation," making it "a reasonable allowance for depreciation."

I have no recommendation to make.

Senator MCCUMBER. Do you mean whether we want to insert in addition to that the word "depreciation"?

Dr. ADAMS. Depreciation is unquestionably in now. The question is whether you do not go far beyond it.

Senator MCCUMBER. You say the word "depreciation" is in. It is not in. You may construe it as being in.

Dr. ADAMS. It is more than covered by the wide language that is used; but you go beyond the ordinary depreciation allowed.

I have brought this up because the committee fully discussed it one day and seemed to have a very definite opinion upon it.

Senator MCCUMBER. Let us see if it covers it:

"A reasonable allowance for the exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

An allowance for exhaustion. There might be no exhaustion. There might be not wear and tear, and yet the value of it might be enormously depreciated. Even though you could not show it was worn out—it might be useless to a certain extent—there would be a depreciation in value.

Dr. ADAMS. That loss of useful life, or usefulness, that you speak of is taken care of by obsolescence. That is one plain thing about obsolescence; but depreciation outside of that we do not want to take care of.

Senator MCCUMBER. The thing might not be obsolete entirely. It might still be usable, and at the same time the value might be depreciated to a considerable extent.

Dr. ADAMS. The value depreciation that you speak of is precisely what has not been wanted in the past and what the department hopes will not be done. You can not allow for constant variation, up and down, of value.

The change in lines 4 and 5, page 39, is purely verbal. We have used different words to convey the same idea; that is all.

The CHAIRMAN. What is next, Doctor?

Dr. ADAMS. Page 40, subdivision (11), is the next:

"Contributions or gifts made within the taxable year to or for the use of: (A) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia for exclusively public purposes; (B) any corporation or community chest, fund, or foundation."

Senator SMOOT. Is that perfectly safe?

Dr. ADAMS. It is entirely safe.

The CHAIRMAN. That is agreed to.

Senator MCCUMBER. I want to say that I object to allowing anything for those gifts. Everybody has his own way to expend for charitable purposes. You may give it to the Red Cross. I may take some crippled child and send that child to a doctor to see if it can not be cured, and I will make my money go further than the Red Cross will. But I am not allowed any exemption, while the man who contributes to the Red Cross is allowed an exemption. I do not think it is right.

The CHAIRMAN. Proceed, Doctor.

Senator SUTHERLAND. What about gifts to colleges?

Dr. ADAMS. A deduction may be taken for gifts to colleges up to 15 per cent of the income. That has been the law for some time.

That is mere method. You may contribute through a community chest, fund, or foundation.

The CHAIRMAN. Go ahead, Doctor.

Dr. ADAMS. Page 41. That change is taken again. There is no change in substance. On page 42 is a provision giving a deduction for property which is "compulsorily or involuntarily converted into cash or its equivalent as a result of (A) its destruction in whole or in part, (B) theft or seizure, or (C) an exercise of the power of requisition or condemnation," etc.

The CHAIRMAN. That is concurred in.

Dr. ADAMS. I must take care of some verbal changes.

The CHAIRMAN. I suggest that Dr. Adams be authorized to put them in.

Senator SIMMONS. Yes; let him put them in.

Dr. ADAMS. Page 43, line 11.

The CHAIRMAN. That is agreed to.

Senator SMOOT. You want to take up line 14—"which determination shall be final."

Dr. ADAMS. I do not greatly care what you do about this. This only relates to the proper apportionment and allocation of deductions with respect to sources of income within and without the United States. You have a provision that income in the case of a nonresident alien shall be allocated. I do not know how it could be made more specific that corresponding deductions should also be allocated. It is a most highly difficult matter. It runs into the most multitudinous detail. In order that some little minute question should not be bickered back and forth and to get some finality I suggested this provision. But the department does not want to urge it at all.

The CHAIRMAN (after informal discussion). If there is no objection, the words will be disagreed to.

Dr. ADAMS. On page 44 there is a provision relating to life tenants and holders of life or terminable interests in which it is provided that they shall not be permitted to take a deduction for the shrinkage of the artificial corpus which is sometimes held to be created and also providing, in lines 12 to 17—

"Nor by any deduction allowed by this act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possesion of the United States, or foreign country for the purpose of computing the income to which such holder is entitled."

Where the income for life is left to a person it may be held that he has received a corpus or principal based upon the capitalization of the expected future annual incomes or annuities. That corpus which is merely the expectation of receiving income in the future naturally shrinks as time passes. Some people have claimed that the allowance for exhaustion which we discussed this morning gave them the right to claim deduction in this connection.

I wanted to have that settled one way or the other.

Senator DILLINGHAM. Does that cover the case of a trust where an individual has certain real estate put in the hands of a trustee where the income is to be applied during the life of the individual and there is a fluctuation in the real estate held by the trustee; how is that affected?

Dr. ADAMS. That is not involved at all. The point is this: Suppose the beneficiary or holder of the interest had a right to receive $5,000 a year for the rest of her life. Suppose such beneficiary was 30 years old when that was given to her. She would then have a so-called capital value equal to the right to receive that in the future. That is merely the right to get income each year. That is, unfortunately, from our standpoint, defined as corpus or principal in many State inheritance taxes. Many people are thus claiming that the corpus which represents merely the present value of the right to receive those incomes in the future is a corpus or principal, and with the passage of time it gradually exhausts, and they want to claim an obsolescence or depreciation against it.

Senator MCCUMBER. Do you mean to say that they want to deduct what they would call the depreciation in the value of the estate in which they have a life interest as they get older, deduct that as against the $5,000 which they received——

Dr. ADAMS. That is involved in the second point. There are two points here.

Senator MCCUMBER. Just explain them so that I will understand it.

(At the request of the chairman Senator McCumber took the chair.)

Dr. ADAMS. Suppose an annuitant has the right to receive $5,000 a year for the rest of her life as income from a life estate. Let us suppose that the actuaries show that she has an expectancy of life of 20 years. There is a capital sum which equals the present worth to-day of the right to receive $5,000 a year for 20 years.

Senator MCCUMBER. How do you apply it in this case?

Dr. ADAMS. I am coming to that. That capital sum diminishes or shrinks as time passes and you reach the end of the term. It is claimed that that value in the beginning, the capital sum, is corpus or principal to the life tenant; that it has a capital value; that the shrinkage of that capital value is exhaustion, for which a deduction should be allowed.

Senator MCCUMBER. They would deduct that, then, from the $5,000 received?

Dr. ADAMS. Yes, sir.

Senator MCCUMBER. I think we can agree to that, if there is no objection.

Dr. ADAMS. Page 44, lines 21 to 25. The present provision relating to dividends has been stricken out and replaced at the top of page 45 by a provision which is as follows:

"(a) The amount of dividends included in the gross income."

Senator SMOOT. Can you tell me why dividends received from foreign corporations are exempt from the normal tax? Under that provision they would be. I do not think they ought to be.

Dr. ADAMS. At the present time they are subject to the normal tax only when the foreign corporation which pays the dividends has no income from the United States. That is so easily avoided by that foreign corporation acquiring a little bit of income from the United States.

Senator SMOOT. I know; you said that the other day. But I do not see why we should exempt from the normal tax the dividends received from a foreign country by an American citizen. I can not see why that should be done. He certainly invests his money over there because of the fact that he thinks he is going to make more than he would by investing it in his own country, or he would not do it.

I know that you brought it up about holding an American bond in a foreign country, and so forth. Under (a) he certainly would not have to pay the normal tax.

Dr. ADAMS. He would not pay the normal tax.

Senator SMOOT. Do you think that is right?

Dr. ADAMS. Senator, that is a very problematical question. I should be entirely acquiescent if you strike this out and do not follow it.

Senator SMOOT. Let us strike it out.

Senator MCLEAN. Was there not some reciprocal idea that other nations were doing this?

Dr. ADAMS. Not with respect to this.

Senator MCCUMBER. Is there not an assumption that he has paid upon that income in the other country?

Dr. ADAMS. The corporation will have to pay upon its entire income in the other country.

Senator MCCUMBER. Suppose a man has an investment in Great Britain and the amount that he makes on his investment is taxed in Great Britain. Then he is taxed again in this country. Is not that the real reason for it?

Dr. ADAMS. That is the philosophy of it; yes, sir.

Senator MCCUMBER. They escape double taxation?

Dr. ADAMS. We tax all the dividends received from the United States. If an individual received income from England as dividends, I do not know, under the British law, whether he is taxable or not; but if the British law is like the American law he is taxable. Mr. McCoy thinks that a dividend received from Great Britain is taxable. I do not know.

Reversing the situation, our law makes the tax on the dividends applicable where the corporation does its business. An Englishman living in England who gets a dividend from the United States is subject to our tax on it. Whether or not an American pays a British tax I do not happen to know.

It is a rather crucial matter and there are two sides to it. I shall not object at all if you disagree and let it go to conference.

Senator SMOOT. I think it is of sufficient importance to ask that we disagree to it and let it go to conference, and then we will look it up and see.

Senator MCCUMBER. I think we ought to look it up before, if we can.

Senator WATSON. I move that the committee take a recess until 2.30 this afternoon.

Senator McCUMBER. If there is no objection, we will take a recess until 2.30 this afternoon.

(Whereupon, at 1 o'clock p. m., the committee took a recess until 2.30 o'clock p. m.)

AFTERNOON SESSION.

The committee met at 2.30 o'clock p. m., pursuant to recess.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Sutherland, Walsh, Gerry, and Simmons.

Senator McCUMBER (presiding). The committee will come to order.

You may proceed, Dr. Adams.

Dr. ADAMS. We were on page 38. I am going to ask the committee to let me take up one little matter we had this morning on page 37, at lines 12 and 13, particularly line 13. We had the provision in line 13, "the taxpayer has acquired by purchase." That would be all right, except for the fact that the provision relating to any losses in line 9 claimed to have been sustained in the sale or other disposition of property would affect that. In other words, a man might trade property. I think we should make another slight change there. That denies the taxpayer the right to claim a loss on a sale when he buys the property back quickly thereafter. It also relates, as will be seen from the language in line 10, not only to sales, but disposition. He may trade them. Because you are applying it to sales and exchanges and other dispositions, the words "by purchase" are not quite accurate. I suggest that it read this way: "The taxpayer has acquired other than by bequest or inheritance."

Senator WALSH. I move the suggestion of Dr. Adams be adopted.

Senator McCUMBER. If there are no objection, it will be adopted.

Dr. ADAMS. Now, then, we come to the $2,500.

Senator SMOOT. Have you thought any more about subdivision (a), so we can settle it as we go along?

Dr. ADAMS. The dividend provisions?

Senator SMOOT. Yes.

Dr. ADAMS. It is a difficult question, and I come with hesitation to the conclusion that I should acquiesce in the House amendment.

Senator SMOOT. Let it go into conference.

Senator McCUMBER. (a) is disagreed to.

Dr. ADAMS. On page 45, line 9, after the word "the" insert the word "aggregate," so as to make that "aggregate net income is in excess of $5,000." It should read "unless the aggregate net income of husband and wife is in excess of $5,000." It is quite an important little point.

Senator McCUMBER. Should it not be "aggregate net income or 'both' husband and wife?"

Dr. ADAMS. Does not the word "aggregate" cover that?

Senator McCUMBER. A man might have an aggregate income, and his wife might also have an aggregate income.

Dr. ADAMS. "Unless the combined net income of husband and wife," might perhaps be better. However, the word "aggregate" is purely a statutory word. "Aggregate" instead of "combined" should be used, because it is a purely statutory phrase.

Senator McCUMBER. Let it be "aggregate."

Dr. ADAMS (reading). "In the case of a nonresident alien individual or foreign trader, the personal exemption shall be only $1,000, and he shall not be entitled to the credit provided in subdivision (d)."

The present credit in this country is made dependent upon the condition of other countries giving a similar exemption to citizens of the United States.

Senator McCUMBER. Let me submit a matter to you that was submitted to me a few moments ago by a person representing several interests. They say, if a resident of Great Britain or subject of Great Britain may live in the United States, buy goods in the United States, and export them into a foreign country, as many others do, and makes his money in the United States, his competitor, an American citizen, buying the same kind of goods, selling to the same kind of people, also makes the same amount; the Britisher here will be relieved from the tax, because he is a foreigner, and the American will have to pay the tax. He will have to pay upon his net income. Is that the case?

Dr. ADAMS. Not at all. That is not the case. The Britisher at the present time is taxed upon his entire net income, if he is a resident here, and will continue to be.

Senator McCUMBER. Suppose he is not a resident, but is simply located here for the purpose of business. He stays here and buys his goods here and exports them to Great Britain or elsewhere. His money is made from the sale of goods in the United States. They claim that under this bill he is exempted from these taxes as a foreign trader.

Dr. ADAMS. Not at all.

Senator McCUMBER. I am not speaking of his exemptions; I am speaking of taxing his income. They say he does not pay an income tax.

Dr. ADAMS. It never entered my mind that he would be exempted. If there is any such danger, it should be guarded against. It never occurred to me.

"The term 'foreign trader' means a citizen or resident of the United States or domestic partnership. (1) 80 per centum or more of whose gross income for the three-year period ending with the close of the taxable year (or for such part of such period immediately preceding the close of the taxable year as may be applicable) was derived from sources without the United States."

If a resident was deriving 80 per cent of his income from outside the United States, he would be termed a foreign trader.

Senator McCUMBER. Here is a foreigner doing business in the United States, buying goods in the United States, and selling them for export.

Dr. ADAMS. Yes.

Senator McCUMBER. They say that under this bill, he being a nonresident or foreigner does not have to pay an income tax, whereas the American doing the same kind of business does pay it. I have not had time to look over the brief, but they are very earnest.

Dr. ADAMS. There may be a point there. I would like to see one of them. I do not appreciate the point at this time.

Senator McCUMBER. I told them I was not aware that was the case.

Dr. ADAMS. It may be so, but I can not see it.

Senator McCUMBER. They insist that is the effect of the law.

Senator GERRY. Why did the House strike out subdivision (e)?

Dr. ADAMS. We are changing the whole method. The credit of the nonresident alien has been reduced to $1,000 by the House for the purpose of not only theory, but practical administration, and that reciprocal provision was dropped.

Senator SMOOT. It is almost impossible to find out the exemptions a foreigner has.

Dr. ADAMS. Yes; and in order to simplify it in every way that change is made on page 46.

Senator McCUMBER. When we come to that portion of the bill which deals with 80 per cent I would like to have you give us your view on this matter. I will ask you to take this letter and look it over.

Dr. ADAMS. I will do so, and will report on it to-morrow.

Senator McCUMBER. I think they are basing some of their claims on this situation: Here is a nonresident living in this country and selling his goods in Brazil. Under the holdings of the department the income comes from the place where the goods are sold, and therefore the income would be in Brazil and not in the United States. It may be that is the point they are making. Therefore, he would be exempted from any profit made from the United States, because the goods, though bought in the United States by a foreigner, were sold to a foreign country.

Dr. ADAMS. So far as you have stated, the foreigner and the American citizen are on exactly the same terms, both under the proposed law and under the present law. I will look that up and report on it to-morrow.

Page 46, subdivision (e), fixes the personal exemption of nonresident aliens at $1,000 flat. No reciprocal provision is contained in it, no allowance for children, and so on. Do you want to agree to that?

Senator McCUMBER. It is agreed to, if there are no objections.

Senator SIMMONS. I do not know that I understand why a nonresident alien should be given an exemption.

Dr. ADAMS. That is a debatable question. He is given all the exemptions at the present time. This reduces them. As a matter of theory he is entitled to that portion of the exemption which his income derived in the United States bears to his entire income.

Senator SIMMONS. What is the principle upon which you give a resident an exemption? It is because he has certain family and personal expenses, and you want to exempt that much from taxation. What have we to do with the

family expenses or the personal expenses of a nonresident, that we should be giving him an exemption from taxation? We have no interest in his living expenses. He is not a citizen of this country. He is not a resident of this country. We have an interest in what he makes in this country, but we are not looking out for his subsistence. I do not see why he is entitled to any exemption at all, upon principle.

Dr. ADAMS. On principle you give him a share of exemption to the share of his total income derived from this country for which he was taxed.

Senator SIMMONS. I do not see any principle upon which he is entitled to equality of treatment with a citizen of this country.

Dr. ADAMS. There are a lot of problematical expenditures, such as medicine, necessary recreation, and so on, that we do not treat as deductions, but in lieu of all those you give an exemption of $2,000. The foreigner is affected by those, the same as a citizen.

Senator SIMMONS. There is an obligation upon us to look after the comfort and happiness of our own citizens, but there is no obligation upon us to look after the comfort and happiness of the citizens of other countries.

Senator LA FOLLETTE. It rests on the same principle that you allow a deduction for certain exemptions in the interest of society, that he should have a certain amount exempted from execution. That same principle is applied to the payment of taxes.

Dr. ADAMS. It is applied to the nonresident.

Senator LA FOLLETTE. You do not believe it is a good principle.

Dr. ADAMS. You understand this proposition is to reduce the exemption to foreigners?

Senator SIMMONS. My inquiry is why we are under any obligation to allow a nonresident any exemption at all.

Senator GERRY. What do the foreign countries do? Do they allow any exemption to our citizens living abroad?

Dr. ADAMS. The foreign practice differs. I think Great Britain allows it.

Senator SIMMONS. If there is any place in this bill where you should invoke the principle of reciprocity, this is the place.

Dr. ADAMS. The point is that we have no way to regulate that. We have no check on the foreigner's family. He can abuse that exemption. We don't know whether he has 5 or 10 children.

Moreover, there is the question of principle as to whether he should have any exemption or not. To settle all these matters as easily as possible, the department recommended a flat $1,000 exemption, which will be considerably less than he is getting now, and will get rid of all these troublesome questions of following foreign regulations and changing our regulations every time a foreign law is changed.

Senator GERRY. My point was not directed at the method of giving the exemption, but at the fact of whether foreign countries gave any exemption to American citizens residing abroad.

Dr. ADAMS. Most of them give the exemption.

Senator MCLEAN. If you do not give him that exemption, and his income would be $400 a year, you would have to tax it. Is it not the idea that it would not pay to collect on any income less than $1,000 under any circumstances?

Dr. ADAMS. While some large incomes are going to nonresidents—I heard of one of $40,000 the day before yesterday—most of them are very small.

Answering the question of what foreign countries do in the way of exempting American citizens residing abroad, that is covered by article 307 on page 111 of regulations 45 of the Treasury Department relating to income tax:

"ART. 307. WHEN NONRESIDENT ALIEN INDIVIDUAL ENTITLED TO PERSONAL EXEMPTION.—(a) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow both a personal exemption and a credit for dependents which satisfy the similar credit requirement of the statute: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Bukowina, Bulgaria, Canada, Carinthia, Carniola, China, Chile, Cuba, Czechoslovakia (including Bohemia, Moravia, and Slovakia), Dalmatia, Denmark, Ecuador, Egypt, France, Galicia, Germany (applicable to 1920 and subsequent years), Goritz, Gradisca, Greece, Guatemala, Herzegovina, Istria, Jamaica, Lithuania, lower Austria, Luxemburg, Malta, Mexico, Montenegro, Morocco, Newfoundland, Nicaragua, Norway, Panama, Paraguay, Persia, Peru, Porto Rico, Portugal, Roumania, Russia (including Poles owing allegiance to Russia), Salzburg, Santo Domingo, Serbia, Siam, Silesia, Styria, Spain, Switzerland, Trieste, Tyrol, Upper Austria, Union of South Africa, Venezuela.

"(b) The following is an incomplete list of countries which in imposing an income tax allow a personal exemption which satisfies the similar requirement of the statute, but do not allow a credit for dependents: Bachka, Banat of Temesvar, Croatia, Finland, India, Italy, Salvador, Slavonia, Transylvania.

"(c) The following is an incomplete list of countries which in imposing an income tax do not allow to citizens of the United States not residing in such country either a personal exemption or a credit for dependents, and, therefore, fail entirely to satisfy the similar credit requirements of the statute: Australia, Costa Rica, Great Britain and Ireland, Japan, the Netherlands, New Zealand, Sweden.

"The former names of certain of these territories are here used for convenience, in spite of an actual or possible change in name of sovereignty. A nonresident alien individual who is a citizen or subject of any country in the first list is entitled for the purpose of the normal tax to such credit for a personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country in the second list he is entitled to a credit for personal exemption, but to none for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either a personal exemption or for dependents. If he is a citizen or subject of any country in the third list he is not entitled to credit for either a personal exemption or for dependents. If he is a citizen or subject of a country which is in none of the lists, then to secure credit for either a personal exemption or for dependents he must prove to the satisfaction of the commissioner that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute.

"SEC. 217. NONRESIDENT ALIENS—ALLOWANCE OF DEDUCTIONS AND CREDITS.—That a nonresident alien individual shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income derived from all sources corporate or otherwise in the United States, in the manner prescribed by this title, including therein all the information which the commissioner may deem necessary for the calculation of such deductions and credits: *Provided*, That the benefits of the credits allowed in subdivisions (c) and (d) of section 216 may, in the discretion of the commissioner, and except as otherwise provided in subdivision (e) of that section, be received by filing a claim therefor with the withholding agent. In case of failure to file a return, the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax."

Senator MCLEAN. Does Great Britain allow any to her own residents?

Dr. ADAMS. Yes; but not to foreigners.

Senator MCLEAN. What are the exemptions in Great Britain?

Dr. ADAMS. They vary greatly, according to the size of the family.

Senator MCLEAN. Suppose an American living in England receives an income of $50, he would have to pay a tax on it?

Dr. ADAMS. So far as I know to the contrary. They do not allow the exemption we allow.

Senator MCCUMBER. Do they not begin somewhere with the income in Great Britain?

Dr. ADAMS. They do with the resident, but they do not begin anywhere with the nonresident, as with us. We do not allow a nonresident alien to get an exemption until he tells us all his income collected in the United States and goes to considerable trouble. Nine-tenths of the income tax on incomes going to nonresident aliens is collected at source. That was true of England. They tax the thing at source and do not inquire into the family status.

You can deny the exemption, you can allow it in full, or you can cut the Gordian knot——

Senator MCLEAN. I think it is a small matter.

Dr. ADAMS. It is a small matter.

Senator MCLEAN. I move we concur with the House provision.

The CHAIRMAN. If there are no objections, it will be concurred in.

Dr. ADAMS. The next is (f). The personal exemption should be determined by the status of the taxpayer at the end of the taxable year. If a child is born during the year he gets the exemption; if a child dies before the end of the year he does not get it.

Senator MCLEAN. I move we concur.

The CHAIRMAN. If there are no objections, it will be agreed to.

Dr. ADAMS. Section 217 is a complicated provision, the necessity of which has been relieved by the action you just took on nonresident aliens.

Senator SMOOT. I want to offer an amendment on page 47, line 17, to insert after the word "associations" the word "bankers."

Dr. ADAMS. I am talking about the matter that was stricken out of section 217.

The CHAIRMAN. What about it?

Dr. ADAMS. It is not necessary. You can strike it out.

The CHAIRMAN. That will be agreed to. Senator Smoot has an amendment.

Senator SMOOT. Page 47, line 17, after the word "associations," insert "bankers and trust companies." "Banking associations" would not take in private banks.

The CHAIRMAN. If there are no objections to the amendment suggested by Senator Smoot, it will be agreed to.

Dr. ADAMS. That takes us over to page 53. The top paragraph is purely mechanical.

The CHAIRMAN. We have agreed to that.

Dr. ADAMS. The provis'on at the bottom of the page relates to gifts. The partnership now does not have a deduction of 15 per cent for gifts. Striking that out would apparently give it to them. This raises the question as to whether a deduction for gifts should be given not only to individuals but to partnerships and corporations. It is very substantive. It is not a departmental recommendation. It is purely a matter of policy.

The CHAIRMAN. The corporations should have power to make gifts to charity.

Dr. ADAMS. The corporation is allowed that privilege and given a deduction up to 5 per cent of its net income.

Senator CURTIS. I move we disagree on both of them.

The CHAIRMAN. The question is on Senator Curtis's motion to strike out the exemption in both cases.

(The motion was agreed to.)

Dr. ADAMS. The matter at the top of page 54 is the result of the personal service change, and ought to stand just as it does in the House bill. It is clerical and should stay in effect as long as the present treatment of personal-service corporations stays in effect. When the personal-service corporations are taxed, as other corporations, it should go out.

The CHAIRMAN. Very well. What is the next?

Dr. ADAMS. On page 55, lines 11 and 12. That states plainly what is practically implicit in the present law. In the case of a trust they may make gifts without the 15 per cent limitation. The change at the top of page 56 is purely clerical.

Senator MCLEAN. At the bottom of page 55 is the gift provision.

Dr. ADAMS. Yes.

The CHAIRMAN. Is that all right?

Dr. ADAMS. Yes.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. The changes on pages 57 and 58 clarify doubtful points in existing law.

The CHAIRMAN. If there are no objections, they will be agreed to. What is the next?

Dr. ADAMS. Page 58, profits of corporations taxable to stockholders. That is the case of a corporation which is using the corporate form to evade or avoid the surtax. That is the point that Senator McCumber and Senator Simmons have been interested in and have asked me to draft some amendments. I have some amendments if you desire to take it up at this point.

The CHAIRMAN. We might as well take it up, unless you have some reason otherwise.

Dr. ADAMS. Senator McCumber, I am coming now to this question of personal service corporations.

Senator MCCUMBER. Yes.

Dr. ADAMS. After much thought and study, the most plausible treatment of the situation would be in connection with section 220. Under section 220 there is first placed on the corporation an additional tax of 25 per cent of its net income as a sort of penalty.

Senator MCCUMBER. A personal-service corporation?

Dr. ADAMS. I am going to discuss the propriety of putting personal-service corporations under that. You want to tax the personal-service corporation as a partnership?

Senator McCUMBER. Yes.

Dr. ADAMS. There was another question also about taxing in the same way investment corporations. The question of the method of taxing them was important, because of possible doubtful constitutionality. The most plausible way of treating that subject, it seemed to me, was that in section 220 as passed by the House an additional tax is imposed on the corporation, and that having been imposed they could get out of it by consenting to pay taxes as a partnership. That makes the adoption of the partnership method perhaps a voluntary method.

Now, coming to the question of the classes of corporations to be included under that method. First, we define a "personal corporation":

"The term 'personal corporation' means a corporation 95 per cent or more of the stock or shares of which is owned by individuals who are regularly engaged in the active conduct of the affairs of such corporation, and the income of which is to be ascribed primarily to the activities of such individuals."

Senator McCUMBER. You use the term "personal corporations" in lieu of "personal-service" corporations?

Dr. ADAMS. Yes; in order to keep them separate while the excess-profits tax continues.

I think that definition for your purposes should not be made to turn upon the absence of capital altogether, because it is easy for them to get a little capital.

Senator SMOOT. Do you not think that large corporations would fall under your definition of personal corporations?

Dr. ADAMS. Irrespective of the size, if the stockholders are working regularly for the corporation and if the corporate income is dependent upon their efforts.

Senator SMOOT. There are some very large concerns that would fall within that classification.

Dr. ADAMS. While I have done the best I can with this, I am not in favor of that. I do not think the personal corporation should turn on the size. Take such a concern as Price-Waterhouse & Co., probably the most prosperous firm of accountants in the world. I think they now have 16 or 18 partners. They have just acquired a $6,000,000 building. If you made it turn on the possession of capital they would escape.

The other class of corporations which you had thought of taxing in the same way I thought of including under the term "close corporations" and I have made a definition of the term "close corporation":

"The term 'close corporations' means a corporation (a) 95 per centum or more of the voting stock or shares of which are owned (1) by one taxpayer (other than a corporation), or (2) by twelve taxpayers or less who are related by marriage or blood, or (3) by any number of taxpayers (other than a corporation) when an agreement or understanding exists that no stockholder or shareholder is to sell his stock or shares without the consent of the others, or (4) by individuals who are regularly engaged in the active conduct of the affairs of the corporation, and the income of such corporation is to be ascribed primarily to the activities of such individuals; or (b) 80 per centum or more of the voting stock or shares is owned by one taxpayer (other than a corporation) and the remaining 20 per centum thereof is owned by less than twelve persons."

Those are the two definitions, one of the close corporation and one of the personal corporation. If you want to apply this partnership method of taxation it could be done very easily under section 220 in this way: You would start out on page 58, line 10, striking out the word "if," and insert in lieu thereof "in the case of (1) a close corporation, or (2) a personal corporation, or (3)," and follow on the section. Upon those corporations you would impose a tax of 25 per cent, which they can escape by voluntarily agreeing to be taxed as a partnership. I don't believe the game is worth the candle, but that is the best I could do with it.

Senator McLEAN. On what theory do you limit the ownership to 95 per cent?

Dr. ADAMS. If an individual owns practically all the stock of a corporation he is the corporation. Why should he be treated differently than the man who owns the business and runs it in an unincorporated form? That is only one definition.

Senator WALSH. Have you any information as to the number of partnerships that have incorporated for the purpose of availing themselves of that very situation?

Dr. ADAMS. No.

Senator WALSH. You think that has been resorted to?

Dr. ADAMS. It has been been done quite a good deal. I know of it through individual cases coming to my attention.

Senator MCCUMBER. I am going to draw an amendment to that matter myself. I believe I can draw one that will meet the law and virtually tax them the same as a partnership.

The CHAIRMAN. If there are no objections. the question will be referred to Senator McCumber as a subcommittee, to report at the opening of the session at 10.30 to-morrow. All data and information relating to the subject is referred to him.

What is the next, Doctor?

Dr. ADAMS. Page 60, the payment of tax at source. Exemption from payment at source is granted with respect to "interest received from foreign traders or foreign trade corporations, and interest on deposits in banks, banking associations," and so on.

The CHAIRMAN. That is a serious step for the committee to take, and I think they should know what they are doing. They are exempting the deposits of foreigners in American banks.

Dr. ADAMS. At this point it is not serious. It was serious before. This is merely the detail of it. The question of principle is involved in the amendment that you inferentially adopted in amending section 217. This section relates to the way the tax shall be collected. If you exempt them in 217 you want to exempt them in 221.

The CHAIRMAN. I do not care what the committee does. I wondered if they knew what they were doing.

Senator WALSH. We did not know what we were doing.

Dr. ADAMS. The provision is intended to stimulate foreign trade and foreign deposits. It applies to foreigners who do not do any business in this country and have no office or place of business in this country. It does not give an exemption to any foreigner engaged in business here. If he has a place of business or office here he gets no exemption, but a foreigner or foreign corporation that wants to buy here and do business here may find it convenient and in some cases necessary to have a bank account here. Is it advisable to provide that interest on daily balances of 2 per cent paid to those foreigners who live abroad should be taxable? The sentiment behind it comes from those persons who think that if we want to stimulate international trade we would better not attempt to impose a tax on these deposits.

Senator MCLEAN. I understand foreign countries do not tax our deposits.

Dr. ADAMS. As a rule they are are not taxed. If an American has a deposit in Great Britain he is not taxed. It is theoretically subject to British law. They don't attempt to collect it. There are a good many things of this kind to stimulate foreign trade. Under Japanese and Canadian law this sort of things are practically exempted.

The CHAIRMAN. If there is no objection, it is agreed to, with the amendment introduced by Senator Smoot.

What is the next, Doctor?

Dr. ADAMS. The amendment in line 15 puts in the word "partnership." That is trivial, and represents the existing practice of the law. It simply covers partnerships as well as individuals.

The amendment in lines 17 and 18 is the dividend matter, and the House language should go back.

The CHAIRMAN. If there is no objection, it is understood that we disagree to that.

Dr. ADAMS. Just as we inserted the word "partnership" a moment ago in connection with the subject of payment of tax at the source, so, on page 61, we suggest that you put in the word "corporation." That omission is apparently an oversight in the present law.

The CHAIRMAN. What is the next, Doctor?

Dr. ADAMS. The next change that I see is on page 63, and has to do with these important credits for taxes. The change is at lines 6 and 7 and, so far as it goes, it extends this credit:

"In the case of a citizen of the United States, the amount of any income, war-profits, and excess-profits taxes paid during the taxable year to any foreign country."

It is impossible to prove and unnecessary to prove. He pays foreign taxes. As we have narrowed this credit a little farther down, it seems well to withdraw that very impossible proposition.

The CHAIRMAN. If there is no objection, that is agreed to. The next is paragraph 3?

Dr. ADAMS. Paragraph 3 has stricken out a reciprocal provision, "In the case of an alien resident of the United States who is a citizen or subject of a foreign country."

We have stricken out the words "who is a citizen or subject of a foreign country." It was a little obscure before. There is no particularly important change in the case of an alien resident of the United States. Reading further, "the amount of any such taxes paid during the taxable year to." Let me illustrate, if I may. Suppose an English citizen was a resident of this country. We would give him this credit if England granted a corresponding credit, but we would not give him any credit for the taxes which he paid in Germany or Switzerland or Sweden. It seems a particularly unnecessary and harsh restritcion.

Senator SMOOT. I move that we agree to the amendment.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. On page 64 this foreign credit is limited, as shown by this language in lines 3 and 4:

"The above credits shall not be allowed in the case of a foreign trader; and in no other case shall the amount of credit taken under this subdivision exceed the same proportion of the tax which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States)."

The notion being that we are not to permit the foreign tax to wipe out a fair share of our tax on income derived from this country.

I want to say for purely explanatory purposes that there has been some little misunderstanding of the word "tax" in the fourth line. I would insert after that word the phrase "computed under Part II of this title." That merely means our income tax.

The CHAIRMAN. It will be put in. The paragraph is agreed to.

What is next, Doctor?

Dr. ADAMS. The change on lines 5 and 6, page 65, corresponds with some of the changes we have made. We do not make them specify each individual country, but "without" the United States.

The CHAIRMAN. That is agreed to.

Dr. ADAMS. The change in new paragraph (d), below, provides that in the case of a fiscal year this credit shall be computed under this subdivision. I think I explained before that where the fiscal year runs over the calendar year and the law changes, ordinarily we compute the tax first for a 12-month period under the earlier law, prorated in accordance with the number of months in the first calendar year; but that is, for a number of reasons, inapplicable and somewhat dangerous with respect to this credit. So, with respect to this credit, we say it shall be this credit—not splitting up the credits under the old law and under this law.

The CHAIRMAN. It is an administrative provision and it is agreed to.

Dr. ADAMS. On page 65, here is a point, gentlemen, that deals with the individual returns. I think some of you asked me to draft an amendment to make this section apply to the gross income and not to the net income.

Senator SMOOT. Is not this the place where we should put in the words "rate of"?

Dr. ADAMS. No; not at this point, Senator; that comes later. The present law is:

That every individual having a net income for the taxable year of $1,000 or over, if single or if married and not living with husband or wife, or of $2,000 or over, if married and living with a husband or a wife."

Do you want that term "net income" changed to "gross income"?

Senator SMOOT. I think that was what we agreed to the other day.

The CHAIRMAN. Is that agreed to?

Dr. ADAMS. That is an important change, now, gentlemen.

Senator MCLEAN. How does it affect every farmer in the country?

Dr. ADAMS. He will have to make his return.

Senator CURTIS. It would increase the work a good deal, would it not?

Dr. ADAMS. Yes, sir. There seemed to be general acquiescence, and I was instructed to draft an amendment.

Senator LA FOLLETTE. Have you any idea, Dr. Adams, how many additional returns this will bring in?

Dr. ADAMS. A great many millions, I think.

Senator DILLINGHAM. Doctor, how many investigations are made by the department to determine whether or not a fraud is committed under the present law by a man's omitting to make a return?

Dr. ADAMS. They keep systematically working on that by visitation, as to incomes over a certain amount, and by taking up section after section of the country for a periodical canvass.

Senator GERRY. Do they not concentrate on the big population centers?

Dr. ADAMS. Not at all. They investigate practically everybody who returns an income of over $25,000. We use this information to check up and find out whether the payee's information returns from the payer have reported the items, and have collected a considerable amount of money in that way. Then they constantly pick out communities to visit to check up on a territorial basis in order to drop down here and there at other times.

The CHAIRMAN (after informal discussion). Dr. Adams, have you any vague idea how much it would cost to receive all these nonproductive returns merely on the prospect of a fishing excursion here and there and tripping some fellow up for a few hundred dollars?

Dr. ADAMS. It would cost a very considerable sum.

The CHAIRMAN. Several million dollars, would it not, for clerical and other expenses?

Senator SMOOT. It will collect more than it will cost, though.

Senator CURTIS. I move that we agree to the House provision.

Dr. ADAMS. I do not think it is worth the extra administrative cost and trouble.

Senator DILLINGHAM. Doctor, are all minor children dependent?

Dr. ADAMS. Yes, sir; up to 18.

Senator DILLINGHAM. In my section of the country they are almost all contributors.

Dr. ADAMS. If they are contributors they do not get any deduction.

Senator DILLINGHAM. They work on the farms.

Dr. ADAMS. If they are supporting themselves they do not get any deduction.

The CHAIRMAN (after informal discussion). It is moved by Senator Smoot that the law remain as it is, with the exception that wherever the gross income is $5,000 a return be made on the gross of $5,000.

(The motion was agreed to.)

Dr. ADAMS. If you will look over the language of the present law in lines 18 and 19, page 65, you will see that it is very confusing. May I clear that up merely for verbal purposes?

The CHAIRMAN. Yes.

Senator CURTIS. I think it ought to be agreed on generally that the doctor may make any clerical amenndments necessary.

The CHAIRMAN. If there is no objection, Dr. Adams will be authorized to insert the technical clarifying amendments necessary.

What is the next change, Doctor?

Dr. ADAMS. That will come before you again to-morrow.

Senator SUTHERLAND. Senator Smoot's motion contemplates the $2,000 where one is married and living with husband or wife?

Senator SMOOT. It is $5,000 gross, now. The net is just as it was.

The CHAIRMAN. What is the next, Doctor?

Dr. ADAMS. On page 68, at the bottom of the page, there is a provision dealing with returns made for a period of less than one year. I had originally written that relating to the surtaxes only. It really should apply to both the surtaxes and the normal tax. The point is that men can reduce their taxes, unless some provision is adopted, by cutting them up and making two returns for a single year. Surtaxes go up in accordance with the amount of the total income. Taxes may be considerably reduced when cut in two halves. It is unimportant, but still it is possible.

I would like to have your permission to change that section and simply make it apply to normal and surtaxes.

The CHAIRMAN. It will be changed accordingly.

Senator MCCUMBER. That is the way I read it now.

Dr. ADAMS. The next change is important, relating to the corporation taxes, on page 70, lines 17 to 20.

Senator CURTIS. We voted on that this morning and made it 15 per cent.

The CHAIRMAN. That is disposed of.

Dr. ADAMS. The next change is on page 71, lines 13 to 16. You have stricken out the limiting provision on fraternal beneficiary societies, leaving this deduc-

tion applicable to all fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members or beneficiaries of members of a fraternity itself operating under the lodge system.

The other limiting condition is taken out. Under the present law such fraternal beneficiary societies must pay life, sick, accident, or other benefit. That is taken out.

The CHAIRMAN. Where did that come from, Dr. Adams?

Dr. ADAMS. This change came from some western organization that was running a fraternal association and did not pay life, sick, accident, or other benefits.

I have no recommendation to make. I indorsed this over in the House because, I thought it would be a troublesome question.

The CHAIRMAN. Would that open the door to fraud, Dr. Adams?

Dr. ADAMS. I have heard so many protests since it was passed by the House that I did not anticipate, that I should prefer to see the matter go to conference, personally, simply to check it up.

Senator LA FOLLETTE. Where did the protests come from?

Dr. ADAMS. One came from a man in whom I have the greatest confidence—Mr. John Walker, sitting here, who thinks it is likely to be abused. I look at it as settling this question which has always bothered me in the past. I do not think the Masons brought this up at all, gentlemen. They were not in the least responsible for it.

The CHAIRMAN. Let us disagree to it and let it go to conference.

Senator WALSH. Let the law remain as it has been.

The CHAIRMAN. Yes. We disagree, and it goes back to the present law.

I have a letter here, gentlemen, from our colleague, Senator Williams, who is a member of the committee, saying that it is a great mistake to tax the dead in any way, and asking that paragraph 5 relating to cemetery companies shall apply to all burial grounds besides those operated exclusively for the benefit of members.

In deference to him I submit it to the committee, together with the very long brief that he presents.

(After informal discussion.) The committee is not prepared to consider the matter at this time, as I understand it.

What is the next paragraph, Doctor?

Dr. ADAMS. Domestic building and loan associations operated exclusively for the purpose of making loans to members.

That change was made on the recommendation of the Treasury Department.

Senator MCLEAN. I move that we concur.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. Line 23, page 71: "Corporations, and any community chest, fund, or foundation," etc. The word "literary" has been inserted.

Senator MCLEAN. I move that we concur.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. On page 72, line 25, we have exempted cooperative associations and extended it to include cooperative purchasing societies as well as cooperative selling societies.

Senator CURTIS. We discussed that the other day.

Dr. ADAMS (reading). "Or organized and operated as purchasing agents." Take out the words "plus necessary purchasing expenses."

Senator LA FOLLETTE. I move we adopt it.

Senator MCCUMBER. It includes all those organizations whether agricultural or not.

Dr. ADAMS. Farmers', fruit growers', or like associations organized and operated as sales agents for the purpose of marketing the products of members, etc. Now, coming down to line 25—

"Or organized and operated as purchasing agents."

I think perhaps Senator McCumber has raised a real point there—that the semicolon at the end of line 24 might better be a comma, and it would be made plainer.

Senator MCCUMBER. Yes. I read it as though it were a new subject.

The CHAIRMAN. It will be corrected accordingly.

Dr. ADAMS. Lines 18 and 19 relate to personal-service corporations.

The next amendment is, on page 74, lines 16 and 17, which takes care of the foreign-trade corporation.

The CHAIRMAN. That is agreed to.

Dr. ADAMS. The amendments on page 75, lines 15, 16, and 17, and 24 and 25, have been adopted in connection with the corresponding individual deductions. These are the deductions allowed to a corporation.

The CHAIRMAN. Agreed to.

Dr. ADAMS. That is true of all the matter down to the change in lines 24 and 25, page 76.

Senator SMOOT. On page 75 you had better put in the word "corporations."

The CHAIRMAN. I think it would be well all through the bill, Doctor, for the sake of avoiding mistakes, if the word "individual" or "corporation" were put in all these headlines.

Dr. ADAMS. I am not so certain that it is not.

The CHAIRMAN. In picking up the bill, which is confusing at best, you might possibly be misled in reading something about a personal proposition that applies to a corporate proposition.

Dr. ADAMS. We have tried to make it plainer than it has ever been.

The CHAIRMAN. If each headline had added the word "individual" or "corporation," it would be better. I do not insist on it. I know I have been confused a number of times in picking up this bill and seeing something about deductions allowed and then have had to look 8 or 10 pages back to see whether I was on the chapter on corporations or still on individuals.

Do you think that is worth bothering with?

Dr. ADAMS. Yes, sir. Mr. Beaman is thinking, and I have thought a good deal, about rearranging the law. I certainly would have asked you about that, except that now you are keeping the old in effect for a single year, and I do not know that it is worth while. A lot of the income-tax provisions stay in effect for a year.

The CHAIRMAN. I would not rearrange it, but I would clarify it in that way.

Dr. ADAMS. We will try to clear that up.

The next change occurs in lines 24 and 25, at the bottom of page 76. "Nor shall such tax be included in the gross income of the obligee."

That is a difficult point that has caused almost more trouble than anything in the law. The point is this: In the tax-free covenant bond the corporation pays the tax for the bondholder, or 2 per cent of it. Now, while the debtor corporation is paying 2 per cent for the bondholder and he is really paying that much tax for himself, still strict theory requires that the bondholder put that in his return as his income. We want to clear that up so that that particular interest shall not be included in the gross income of the obligee.

Senator SMOOT. I have a letter from the American Bankers' Association, in which they make this statement:

"The amendment which our committee adopted"—that is, the committee of the American Bankers' Association and the bankers whom they represent—"should be, we believe, inserted following the word 'trader,' subdivision (c), section 234 of the revenue act of 1918 as follows."

Dr. ADAMS. I suppose that is the provision giving them a deduction for taxes?

Senator SMOOT. It says including taxes paid, which are imposed against stockholders of corporations on the value of their stock in such corporations.

Dr. ADAMS. Can I get a vote on the change as to obligees?

The CHAIRMAN. Certainly.

Is that agreed to? In the absence of objection, it is agreed to.

Dr. ADAMS. Now, Senator Smoot, reverting to your proposition, the Bankers' Association are asking that they be allowed to claim deduction for State and local property taxes which they pay. The banks pay these taxes for and on behalf of their stockholders. The taxes, you will remember, are on the stockholders. The bank voluntarily assumes it and pays it. The banks now want to claim a deduction for it. They do it almost universally.

Senator SMOOT. If it were the stockholder it would be allowed, but as long as the bank takes it out, they do not allow it.

Dr. ADAMS. They pay it voluntarily. A pays B's taxes voluntarily. The banks pay it voluntarily.

(Informal discussion followed.)

Dr. ADAMS. Banks may be given a deduction because, as a matter of strict legal theory, it is imposed on the stockholders and the stockholders do not take it. This is what worries me. The Revised Statutes provide the manner in which the banks shall take. The Federal statute provides this, that the States may tax the real estate of national banks as other real estate is taxed, and

that, in addition, the value of the shares of the national banks may be included in the personal property of the shareholders. That is only taxed at the place where the bank is located. The consequence is that a habit has grown up of assessing the shareholders of the national banks and asking them to pay it.

In June, I think it was, this question came up in the case of the United States versus the Merchants' Bank of Richmond. That is the case, as I recall it. The decision was rendered on June 6, I think.

The State of Virginia imposes a low rate of property tax, so called. You know that it is now customary in many States to adopt a low rate on property—bonds, stocks, securities, and so on—and the question came up as to whether or not, in Virginia, this bank stock would have to be confined to the low-rate property tax imposed on other stockholders, or whether the tax might be more. The Federal statute says that this stock shall not be taxed at a higher rate than other moneyed capital. The Supreme Court of the United States held that if the State had one of these low-rate taxes on intangible property—securities and the like—that that was all that could be imposed on the bank shares.

Taking advantage of this recent decision, I think the banks will use the Federal statute in order to get the much lower rates that go with this low-rate State tax on securities. For instance, it is 4 per cent in Connecticut, 4 per cent in Iowa, and limited for a long time in New York. I think that it is wise to limit rates on securities, but the point is that the banks have announced their intention to take advantage of this statute, and so long as that is true, the legal theory which imposes in most States the tax on the shareholder and not on the bank, is a very significant matter, and my opinion is that the States ought to get relief here by having the tax put upon the banks. If the State and local taxes are on the bank, they will claim exemption.

Senator SMOOT. I have been a director in a bank out in Salt Lake City for over 20 years. They have paid that tax ever since I have owned a share of stock in the bank. I have never taken a single cent deduction in any way. I am president of a bank, too, and they pay every single cent of that tax. I know nothing about it. I do not take 1 cent of credit for deductions, and the banks are entitled to it. They pay it out.

This amendment reads: Including taxes paid, which are assessed against the stockholders of their corporations.

Senator WATSON. Just a moment. Where do you want to put it?

Senator SMOOT. In the proper place.

Dr. ADAMS. If you will adopt it in principle, we will put it in the proper place.

Senator MCCUMBER. What is the sense of the committee?

(After a vote.)

Senator MCCUMBER. The vote is 6 to 3; the motion is carried.

Senator SMOOT. I will leave that amendment with you, Dr. Adams.

Dr. ADAMS. We come next to the top of page 77—losses sustained during the taxable year and not compensated for by insurance or otherwise.

There was some discussion in the case of individuals. Shall I do it the same here as with respect to individuals?

Senator SMOOT. Yes.

Dr. ADAMS. That is, make the same changes here as were made with regard to individuals?

Senator MCCUMBER. Without objection that is agreed to.

Dr. ADAMS. Number 5 was stricken out in the conference.

This dividend business you reserved, Senator Smoot.

Senator SMOOT. Yes.

The CHAIRMAN. What is next?

Dr. ADAMS. There is no change here. Line 22 is purely formal. There are no changes on pages 78 and 79.

The provisions on page 80 relate to insurance, and can, I think, be taken up intelligently only when you take up the insurance sections, so that I move that that be passed over.

The CHAIRMAN. All right. Didn't you take that up separately the other day?

Dr. ADAMS. I explained it somewhat, but you had not come to it to vote upon it.

"Contributions or gifts." This is the thing that you have rejected.

The CHAIRMAN. Yes, that is rejected.

Senator LA FOLLETTE. That is, 15 goes out?

Dr. ADAMS. Yes.

The CHAIRMAN. What is next?

Dr. ADAMS. The next is the section that you have worked on with respect to individuals. I would like to make corresponding changes.

Senator SMOOT. What about section 7—the rehabilitation act? Did you look that up? I called your attention to it some time ago.

Dr. ADAMS. I have asked to have it looked up, Senator Smoot. I left word to that effect. I did not have the time to look that up myself.

Senator SMOOT. That is understood then, if we agree to this.

Dr. ADAMS. This is out, anyway; it comes in elsewhere. There is nothing new.

Senator SMOOT. Have you passed on 16?

Dr. ADAMS. Sixteen is exactly the same as the paragraph under individuals.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. The changes in lines 10 to 12, page 84, are exactly the same as in the case of individuals.

Senator SMOOT. Yes; those are the same.

The CHAIRMAN. What is next?

Dr. ADAMS. The change on page 85.

The CHAIRMAN. That is agreed to.

Dr. ADAMS. That becomes 15 per cent, I take it.

The CHAIRMAN. Yes.

Dr. ADAMS. Page 86, line 8. That is a change had in individual cases also. These are credits for foreign taxes; that is, credits for taxes paid in foreign countries. That is, so far as I recall, identical with the individuals.

We come next to page 89—consolidated returns. On page 89 is a provision which makes consolidated returns of corporations optional as soon as the excess-profits tax is abolished. That is the substance of it.

Senator SMOOT. That is, if the excess profits tax is repealed, this is O. K.

Dr. ADAMS. This is an optional provision effective January 1, 1922, when the excess-profits tax is repealed.

The CHAIRMAN. What is next?

Dr. ADAMS. The last subdivision is on pages 91 and 92, there being a provision authorizing the Commissioner of Internal Revenue to make a consolidation of corporations in order simply to determine the correct net income of each, not to tax them but to prevent milking. It authorizes the Commissioner of Internal Revenue to consolidate them for the purpose of ascertaining the proper net income in any event.

The CHAIRMAN. That is agreed to.

The next is insurance, is it not?

Dr. ADAMS. Next comes insurance.

The CHAIRMAN. Can't you tell us what the insurance proposition is? We know it pretty well.

Dr. ADAMS. The present law is working unsatisfactorily in the case of insurance companies. But I am not prepared to-day to make recommendations and wish you would let the matter go over. The House plan is admirable for life insurance companies but is not suited to other companies. I have not yet any substitute to propose for the other companies. I wish you would let it go over.

Senator DILLINGHAM. Some of the life insurance companies were perfectly satisfied with that.

Senator SMOOT. Now that we have made it 15 per cent instead of 12.5 per cent, what reason is there that this should not be 15 per cent?

Dr. ADAMS. The rate should be that applicable to other companies.

Senator SMOOT. Then we ought to make this 15 per cent. We have made it 15 per cent in the case of the other corporations, so why not make this 15 per cent?

Dr. ADAMS. The idea is in the case of insurance companies to have them pay the same rates.

The CHAIRMAN. Will you bear Senator Smoot's suggestion in mind, Dr. Adams?

Dr. ADAMS. Very well.

The CHAIRMAN. What comes after insurance?

Dr. ADAMS. Page 97—administrative provisions.

The CHAIRMAN. The administrative provisions come next. Do they alter the substantive part of the bill?

Dr. ADAMS. In this section, 250?

The CHAIRMAN. No; your administrative amendment.

Dr. ADAMS. There are some substantive amendments there. I wish I could skip it all.

The CHAIRMAN. Are they of a character that we could authorize you to put in?

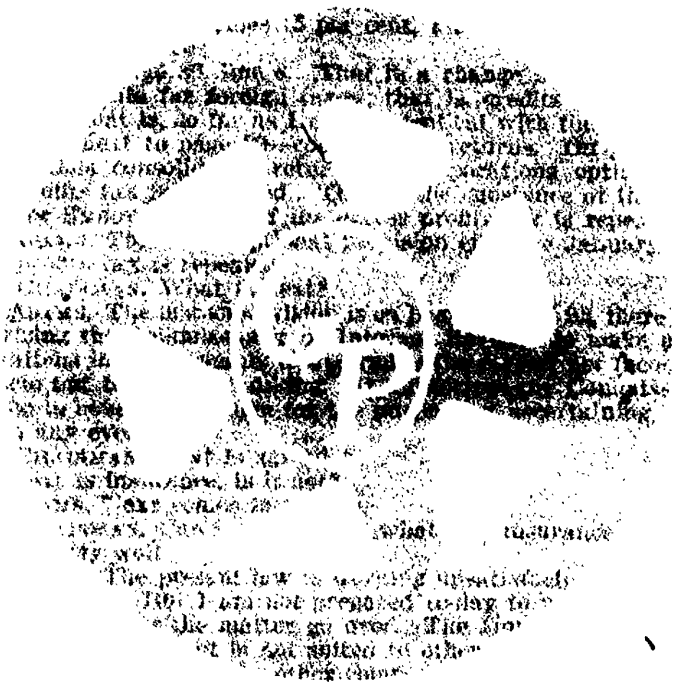
Dr. ADAMS. If you will authorize a subcommittee composed of Senator Smoot and whoever may be interested in it, I shall be glad to take it up.

The CHAIRMAN. I will appoint Senator Smoot as one member of the committee and Senator Walsh as another.

Dr. ADAMS. This is to take up the administrative provision.

The CHAIRMAN. I will ask the subcommittee which has been announced to confer with Dr. Adams. I think that in half an hour or so you can clean up the whole thing.

(Thereupon, at 4.45 o'clock p. m., the committee adjourned until to-morrow, Wednesday, September 14, 1921, at 10.30 o'clock a. m.)



INTERNAL REVENUE.

WEDNESDAY, SEPTEMBER 14, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Sutherland, Simmons, Gerry, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. At the time of adjournment on yesterday a subcommittee was appointed to consider the adoption of certain minor amendments. That subcommittee, consisting of Senator Smoot and Senator Walsh, conferred with Dr. Adams and reports this morning in favor of the adoption of a considerable number of minor amendments.

Senator LA FOLLETTE. Just what did you do, Dr. Adams?

Dr. ADAMS. Senator, section 250 is the section relating to installment payments and the imposition of penalties and interest and that kind of thing. It is a section of law where you have to specify with exactitude. We have not changed the regulations, except to put a shorter limit of three years upon the department, making the department clean up in three years, instead of five, as it is now required to do.

We have gone through the section and straightened out a certain number of points that needed to be stated with extreme exactitude. Those changes must be very exact. The courts study these sections word by word; it is a meticulous proposition.

Senator MCLEAN. When we went over the bill originally, Dr. Adams, you made a statement covering the changes, which changes will be contained in your printed statement.

Dr. ADAMS. Yes, Senator; but even there you must remember that those changes are very numerous and could not be made with the exactitude that is required.

As an instance of what we have done, may I say that we changed the word "willful" to the word "intentional." That, curiously enough, is an important change. That occurs on page 99, line 23.

Senator LA FOLLETTE. How do you distinguish?

Dr. ADAMS. Taking the word "willful," we have to prove an element of fraud, which is really not necessary. That is a good illustration. The word "willful" means that you did it willfully; that you meant to defraud the Government. The word "intentional" means that you meant to deliberately disregard what you had been instructed to do. That is the real point.

Then, here is another typical case. It begins on page 100 at line 10. (Reading:) "The penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns willfully made," and so on. As a matter of fact, section 3176 of the Revised Statutes does not provide a penalty for false or fraudulent returns willfully made. It provides for attempts to defeat or evade the tax. These provisions must be absolutely perfect with respect to language; at least, so far as we can make them so. So we changed that around and put in the thing that is really meant to be provided for; that is, attempts to defeat or evade the statute.

May I take another illustration? On page 101, line 13, we are putting on a five-year statute of limitations with respect to assessments and are forgetting what is back of it. We use the words, "And the amount of tax due under any return made under this act for prior fiscal years or under prior income, excess profits, or war profits tax acts." I thought, off-hand, that I had stopped practically everything back of five years, but the excise corporation tax of 1909 is not, technically speaking, an income tax or a war-profits tax. In other words, we would be left with a lot of little suits, or the possibility of a lot of little suits, under the war excise tax of 1909, which was abolished in 1913. It is nearly nine years ago that that was abolished. I suggested some phraseology that would cover it. As a matter of fact, they have told me that there is a possibility of about 300 suits being instituted involving $100 or $120. It would seem foolish to bring them at the present time. That is another one of those changes.

Senator LA FOLLETTE. Without going into it fully, Dr. Adams—and I want to say that I have the greatest confidence in you and I think you know more of the subject than anybody else in the world—are there any changes made in the administrative features here that will cost us any considerable amount of revenue?

Dr. ADAMS. There is nothing here at all of significance, except the legal specifications to which I have referred. There are some changes in section 250, but they are not in the direction of changes of the law. They are in the way of making the law more explicit.

In section 252 we did provide this. This is the section, you will remember, providing for refunds. We have placed on the Government a five-year limitation and on the taxpayer a five-year limitation.

You well know that under the excess-profits tax everything turns on invested capital. You get your principle of 8 per cent exemption on invested capital. Now, invested capital, in turn, includes accumulated earnings, and to get at the earnings you have got to go back and trace the history of the corporation to see whether the accumulated earnings have been properly computed. That means, under the excess-profits tax, that we should go back to the origin of the company, even if it was back as far as 1888. We would go back as far as we could. We may find in our examination somewhere some manifestly incorrect calculation of the earnings. One of the most common defects and one of the most common errors is the failure of the corporation to take sufficient depreciation into consideration. That is one of the most common mistakes for corporations, and that was particularly true before the income-tax rates became heavy. The corporations failed to take sufficient depreciation. Under such circumstances the accurate auditor would say, "Gentlemen, in your 1914 return you did not take enough depreciation. The thing that you claim is accumulated earnings is not accumulated earnings. You have not established your depreciation yet." The result is to reduce the amount of their invested capital and increase their expenditures for the period under consideration. If you force them to do that and rake them over the past, it seems to me that it is only fair to give them a rebate for taxes overpaid.

In 1914 the rate was 1 per cent. Assume that a man ought to have taken, say, $20,000 depreciation. He should have taken that much. If we make him do that, then it seems harsh to cut that down and not say, "You can shake up your taxes for that year; it will be taken as a credit against the excess-profits tax." The only way in which the Government's revenues would be reduced at all would be in that kind of case. I do not think that that would really reduce the revenue, because I think the auditors would probably fail to go back so carefully if there were not some such provision.

There are some things about taxation that you learn only with practice. There is one thing that you can be absolutely certain of, and that is that any provision, judged by moral law, that is unduly unfair tends to demoralize your officials. If it strikes him that it is unfair, he will not carry it out. He will not enforce it. I know that from my service on the Wisconsin tax commission and my service in connection with other bodies. If you have a proposition that is manifestly unfair, you may storm at your assessors and auditors, but you can not get by with it. So, while this may tend to allow some refunds, I do not think that we shall lose by it; in fact, I think that we shall gain by it. That is true of all these equitable provisions. I do not think they lose the Government money.

Take, as an illustration, the case of the traveling man. That provision does not lose money for the Government; it gains money for the Government. The

average traveling man did not abide by the old rule. He says to himself, "Here, they are not playing fair with me; I will forget this little source of income." The net result is to increase the returns. I do not think for a moment that the movement along the line of allowing him what he ought to have has lost us money; it has simply gained us money, because you have brought about a reaction on the man.

In any event, the amount is not large. That is the only place that I recall such a provision.

As I have said, we changed this 3-year provision to five years, with respect to assessments made under this act in the future.

The CHAIRMAN. I have always argued that we did not want the last drop of blood and that we had better have cheerful taxpayers.

Senator CURTIS. Let us adopt this, then.

The CHAIRMAN. Upon Senator Curtis's motion the amendments to the administrative part of the bill, recommended en bloc by our subcommittee, consisting of Senator Smoot and Senator Walsh, will be agreed to. If there is no objection, that is the understanding of the committee.

Dr. ADAMS. I do not think there is anything at all of importance.

The CHAIRMAN. That is settled. That brings us down to what?

Senator SMOOT. Down to page 116.

Senator MCCUMBER. What about page 101–D—"The amount of tax due under any return made under this act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the commissioner within three years after the return was filed," and so on.

The old law was five years. Why shorten it to three?

Dr. ADAMS. Simply because the delay was an abuse and the work should be done more promptly.

Senator MCCUMBER. I would like to hear from Mr. McCoy on that.

Mr. MCCOY. I have no opinion, except that I do know that in 1917 we were limited to three years, and the Government lost millions of dollars because they could not get to the returns.

Senator MCCUMBER. This is five years, and it will at least give the Commissioner of Internal Revenue time enough to cover them.

Mr. MCCOY. That is simply the case with the 1917 returns. I do not know how it would be with the other returns. In the 1917 returns the Government lost millions of dollars because they could not be audited.

Dr. ADAMS. The Government has not lost millions of dollars. The time limit expired in March, but we got waivers from about 65 per cent of the taxpayers.

Mr. MCCOY. You did not get waivers from all of them.

Dr. ADAMS. No. I say that we got waivers from about 65 per cent of them. As to the future years, Mr. McCoy, don't you think that three years will be enough; that the Government ought to get in shape and finish up in three years?

Mr. MCCOY. I do not question at all that they ought to do it, but they are not doing it.

Senator MCCUMBER. Are you going to attempt to drive the Government to do it without a sufficient force?

Senator SMOOT. In 1917 they did not have the men. They were not then in the shape that they are to-day to audit these accounts.

Mr. MCCOY. Those accounts were audited up to last March, and up to then they had more auditors than they have now.

Senator CURTIS. The auditors have said that they can do twice as much work as they are doing now if you will give them the work.

Senator MCCUMBER. We want to know that we are not going to lose anything by putting a time limit on them and making it too short so that the returns can not be carefully audited.

Dr. ADAMS. It is true that the mechanism of the audit is poor and that the whole situation is bad, but the explanation of the great delay is the fact that the new war taxes were infinitely more complicated than anything we had had before. There was the question of the new invested capital. That is an awful thing to work out. All that was dumped upon us in the midst of those strenuous times and the situation became more complicated than anything we had ever known before. So long as you keep the rates that you have, you will have to have complicated relief provisions. The excess-profits tax was new, and with the expansion of numbers and the infinite increase in the importance of the cases, the amount of work became enormous. In 1916, for instance, we had a 2-per-cent tax on corporations. Within two years after

that we had a potential tax of 80 per cent. When men quibble about 2, 5, or 6 per cent rates you can imagine the condition when a potential increase to 80 per cent is mentioned.

As to the 5-year period, if that is too long, and if the Bureau of Internal Revenue can not finish up the tax returns in three years, the legislature ought to change that tax or it ought to change the office.

Senator McCUMBER. What will be the effect if they do not?

Dr. ADAMS. You can say to these gentlemen, "You have three years in which to finish this work." We are doing this advisedly. Say to them, "You have got to finish up in three years."

Senator WATSON. Why not make it four years and make it sure?

Senator SMOOT. If we give them notice here that within three years we expect this matter cleared up, they will clear it up. A great many of these complicated matters will be cleared up, beginning next year, and if we put this at four years they will always think of four years, saying to themselves, "We have four years in which to do this work;" and it will take that length of time. On the other hand, if you say three years, they will do it in three.

Senator WATSON. Very well.

The CHAIRMAN. Without objection, that will be agreed to. What is the next, Dr. Adams?

Dr. ADAMS. I shall have to take you back for a moment to page 34. There is a point that has come up in connection with line 22. I bring this to you for consideration. This is the point. You will recall that you define as income from sources within the United States, both in the present law and in the House bill, interest derived from residents. In other words, if an alien who happens to be a resident of this country, or a foreign corporation which happens to be a resident of this country, derives interest here, that alien or that corporation will pay taxes. Now, a foreigner, particularly a foreign corporation, may be a resident and still have but a very small percentage of its income from this country. For instance, I can illustrate that by an extreme case:

A Canadian railway, wishing to borrow money in this country, although it had no business in this country and none of its lines touched the United States, came to New York to borrow money. It borrowed a large sum in Wall Street. In order to facilitate payment of interest and for the purpose of service of process it was required in the instruments on the bond to maintain a New York office. That is all it had, but it became by reason of that fact a resident of the United States, and immediately thereafter, although it had no business in this country and no line in this country, interest on its obligations became taxable under the law.

Senator McCUMBER. On the railroad's obligations?

Dr. ADAMS. On the railroad's obligations. The interest paid to a nonresident alien, the Canadian railway, which had no line in this country and no business in this country, was subject to our tax, and the tax was withheld at the source. That seems to be the extreme. I have tried to cure that. I want to suggest this for your consideration. It has been urged strongly and I think with justice. On page 34, line 22, after the words "Section 217," insert this amendment:

"Interest and dividends received by a nonresident alien or nonresident foreign corporation from resident aliens or resident foreign corporations shall not be included in the gross income when it is shown to the satisfaction of the commissioner that such residents have derived less than 50 per cent of their income from sources within the United States, as determined in section 217, for the three years ending with the fiscal year of such residents."

If after three years the resident corporation is getting less than 50 per cent of its income in this country, and if the corporation in turn pays interest to a nonresident alien or a nonresident foreign corporation, the latter would not be taxable in cases where they take the trouble to show the department that they are getting less than half of their income from the United States. That is the suggestion that I have to make.

Senator SMOOT. Why do you want to make it 50 per cent? Isn't that rather high?

Dr. ADAMS. If it is doing half of its business in this country, we hold that, in the main, its income is derived from this country.

Senator SMOOT. It seems rather high.

Dr. ADAMS. You may reduce the percentage if you desire.

Senator SMOOT. It seems to me that it ought to be reduced.

Dr. ADAMS. In the case of the foreign trader, even though he is an American, interest paid by the foreign trader to a nonresident foreigner is not taxable under the House bill. There the foreign trader is defined as one who gets less

than 20 per cent of his income in this country. You might use that if you want to.

Senator McCUMBER. You do not make the matter clear to me. I do not quite see the point in connection with the Canadian railway whose agent comes to this country for the purpose of borrowing money. As I understand it, in order to have service upon the corporation debtor in the United States you compel that railway to appoint an agent to receive service in this country.

Dr. ADAMS. And maintain an office here.

Senator McCUMBER. And maintain an office, of course Now, the debt which is due from the Canadian railroad would be due to the American bank giving the credit, or whatever it was.

Dr. ADAMS. Yes.

Senator McCUMBER. If it were due to an American bank, would not the American bank be responsible? Would not that be part of its profits, and would it not pay the taxes on that even though the money was received from a foreign corporation? When the loan is made in the United States the agency of the foreign corporation is in the United States and the money that is received is payable in the United States. Would not that bank be taxed upon everything that it received?

Dr. ADAMS. That is not the point. The American banker underwrites this loan and sells bonds wherever he can. In this case most of them happen to be held in Canada and in England. That Canadian railroad becomes a resident of the United States. The law provides that all interest paid upon obligations of residents——

Senator McCUMBER (interposing). All interest paid upon what?

Dr. ADAMS. Upon obligations of residents.

Senator McCUMBER. But the resident is not the obligator.

Dr. ADAMS. The Canadian railway is the resident. One of its obligations was the bonds, and the interest on those bonds is taxable in this country, even though the bondholder resides abroad.

Senator McCUMBER. In fact, the Canadian railway is not a resident except for the purpose of process serving and the maintenance of an office. Why not cover that by excepting this case from its operation without having this 50 per cent proviso, etc.

Dr. ADAMS. I am just using that as an illustration. Suppose that the Canadian railway did a little business in this country, but that it was only 1 per cent of its income.

Senator McCUMBER. But in the case you mention there ought to be no tax whatever.

Dr. ADAMS. I think so.

Senator McCUMBER. Therefore, you should make an exception of those cases so that those people would not be taxed at all. If it is a nonresident receiving money from a nonresident, or a foreigner receiving money from a foreigner, even though underwritten by a citizen of the United States, it does not seem to me we should take anything whatever on that. If there is any other business that is United States business, let that stand upon its own merits.

Dr. ADAMS. That was merely an illustration. Suppose the Canadian company receives one-tenth of 1 per cent of its income from real business in this country.

Senator McCUMBER. Then tax it upon the one-tenth of 1 per cent.

Dr. ADAMS. But can we pro rate that? It would be an impossibly complex provision. Take the proportion of its income earned in this country and tax that much of the interest. My illustration represented a mere class of cases.

Senator McCUMBER. You could tell what it was in the United States.

Dr. ADAMS. It is not so easy.

Senator McCUMBER. You could tell without prorating. Could you not determine what it earned in the United States and make provision for taxing that?

Dr. ADAMS. Senator, I am afraid that we do not understand each other. The point is that interest paid on the obligations of a resident is taxed, although he may earn but one one-hundredth of his income in this country. I want to modify that. I can not think of any simpler way than the one I have suggested.

Senator McCUMBER. You are making this a 50 per cent remedy.

Dr. ADAMS. I am not. I am holding that the foreigner should be deemed to be a resident only when he gets more than half of his income in this country. I am not taxing the interest on that half. I suggest that interest shall be wholly taxed if the foreigner earns more than 50 per cent over here; if he earns less than 50 per cent, we shall not tax it at all.

Senator McCUMBER. I can not see why money that a foreigner earns and that is paid to a foreigner should be taxed at all.

Dr. ADAMS. I am simply endeavoring to temper the law that goes to the other extreme. Do you want to say that no interest paid by an alien or a foreign corporation shall be subject to our tax?

Senator McCUMBER. No. I mean by a foreign corporation to a foreign corporation.

Dr. ADAMS. Will you say that even though it earns 99 per cent of its income in the United States?

Senator McCUMBER. No. I say that if a Canadian railway company, earning its money in Canada, is owing a debt upon bonds issued by it, though the money were borrowed in New York and the bonds were held in Germany, that we should not tax the sum that was paid to the German holder; and it does seem to me that we can make that law so that it will not be so complicated, without going into this 50 per cent proposition.

Dr. ADAMS. Let us suppose that the Canadian railway was, instead, a Canadian manufacturing corporation. Let us suppose that it earned 99 per cent of its income in this country. Let us suppose, further, that the directors got together and said, "We have $1,000,000 of stock; we will make it $900,000 of bonds and $100,000 of stock. Then nine-tenths of that amount would go out in bond interest. Now, what are you going to do? Are you going to exempt that bond interest altogether?

Senator McCUMBER. I am thinking simply of the principle of taxing the foreign corporation on money which that corporation pays to another foreign corporation.

Dr. ADAMS. The trouble with the whole thing is that the Congress has changed it. The rule was that interest should be taxable at the domicile of the resident. The matter went to the Attorney General for decision or an opinion. It was the opinion of the Attorney General that interest received by a foreigner in this country is not income derived from the United States. Congress, however, said that all interest paid by any resident, no matter whether he was a foreigner—a foreign corporation or a domestic one—should be taxable. Not only did the Congress do that, but Congress said, "We will stop it at the source."

My idea was to have a simple remedy. It never occurred to me that you would go back to the old rule. It might be well to say that all interest received by a resident of the United States shall be taxable and all interest received by foreigners shall be exempt. That would be a simple rule; but legislative history taught me that you wanted to get at the interest when it represented interest on American business. I wanted to get at that and at the same time not to have it so complicated.

Senator McCUMBER. I do not see why you can not tax the income made by a foreign corporation in the United States on its American business, and not tax it—merely because it has an agent here or a mere place of residence here—on money it earns in any other country and pays in any other country. It should be relieved from that.

Dr. ADAMS. Senator, the largest gold mine in the world, in point of output, is owned by an English corporation in this country. I do not know how it is financed. Let us assume it is financed with $10,000,000 of stock. Suppose that we switch that around and make it $4,000,000 of stock and $6,000,000 of bonds. A large part might then go into the form of bond interest. I suppose that is what influenced Congress to change the rule. Theoretically, I would rather agree with you. However, I had not supposed that Congress would consider it.

Senator McCUMBER. In any case you would tax the earnings of the corporation on its net income in the United States.

Dr. ADAMS. To carry it out, suppose there are $6,000,000 of bonds and $4,000,000 of stock out of the $10,000,000. Probably six-tenths would go in the form of bond interest. You see, it can be shifted around very easily.

Senator McCUMBER. You evidently do not understand my objection and the point that is troubling me. It is not the case of actual earnings in the United States. I am in favor of taxing them, but I am not in favor of taxing them when the earnings are made by an outsider and paid to an outsider. What reason can we give for taxing them, no matter what they made in the United States?

Dr. ADAMS. I do not think you can give any good reason, but it has gradually become the policy of the law.

Senator CURTIS. I suggest that we reduce that to 25 per cent.

The CHAIRMAN. Senator Curtis has suggested that 50 per cent be reduced to 20 per cent.

Senator CURTIS. No; 25 per cent.

The CHAIRMAN. Are you willing to make it 20?

Senator CURTIS. Yes.

The CHAIRMAN. Is there any objection to concurring in the proposition as offered by Senator Curtis. If there is no objection, it will be agreed to.

Proceed, Dr. Adams.

Dr. ADAMS. On page 12, at the top of the page, in "(c)" there is a change.

"In ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, proper adjustment shall be made for (1) any expenditure properly chargeable to capital accounts, and (2) any item of loss, impairment, exhaustion, wear and tear, obsolescence," and so on.

That is a provision which enacts into written law what has been unwritten law. I put it in there for a number of reasons, but particularly because there has been some little doubt as to whether capital charges should be added to the original cost basis.

Senator SMOOT. That is on page 12, you say?

Dr. ADAMS. Yes; subdivision (c).

The CHAIRMAN. Didn't we settle that before?

Dr. ADAMS. I was going to ask to strike it out.

The CHAIRMAN. Strike out what?

Dr. ADAMS. The whole of subdivision (c), on page 12, lines 6 to 12, inclusive. The point is simply this. It is psychology alone. This has been going on. We have done this in a general way. The Commissioner of Internal Revenue thinks, as a matter of psychological effect on the agents, that it will cause a great lot of trouble that is unnecessary if we put this change in here. I think the commissioner is right. I had not thought of it in that aspect before. I think it would be wise to take it out. The principle is now accepted and adopted, but being one of those things that is not particularly emphasized by written word, they do not make a prominent or irritating thing of it. If you go ahead and write it into the law, they will think you are laying particular stress upon it, and it may cause a lot of trouble.

The CHAIRMAN. You say that it has a bad effect?

Dr. ADAMS. Yes.

The CHAIRMAN. I should say that it would have a beneficial effect with respect to the psychology of the taxpayers.

Dr. ADAMS. Number 1, line 8, the first part, protects the interest of the taxpayer, but number 2, lines 10 to 12, inures to the benefit of the Government. The commissioner thinks the agents will be especially interested in lines 9 to 12; that that will be the psychological effect of it. He thinks on the whole we had better not strike it out.

The CHAIRMAN. Let us strike it out and let it go to conference.

Senator SMOOT. What about "(f)" at the bottom of page 13, reading: "The basis for ascertaining allowable deductions for loss, exhaustion, wear and tear, obsolescence," and so on. Do you want that to go out, too?

Dr. ADAMS. Absolutely not. That is substantive and that tells a thing that has been in doubt. I want that fixed.

The CHAIRMAN. Why was that put in, Dr. Adams?

Dr. ADAMS. To what do you refer?

The CHAIRMAN. This paragraph that you want us to strike out.

Dr. ADAMS. Because it writes natural law into written law. I thought there might be some doubt. I still think it would be good if it were not for the peculiar circumstances and the psychology of it as it affects the agents.

The CHAIRMAN. I thought "(c)" was all right.

Senator SMOOT. Of course, "(f)" is the same thing on the value of property as of March 1, 1913.

Dr. ADAMS. Let us suppose a taxpayer has a piece of property which costs $10,000 and becomes worth $15,000. He exchanges—he does not sell—it for property which is worth $15,000. He would have a gain there, and he would be taxable on it. Thereafter he would take depreciation on the larger value. But you are now taking, under this section 202, a lot of cases and saying in those cases that no gain shall be reckoned.

Senator SMOOT. That is in "(f)"?

Dr. ADAMS. That is in "(f)." But he shall take $10,000 for depreciation.

Senator SMOOT. But "(c)" is on whatever improvement has been made on the property as of March 1, 1913.

The CHAIRMAN. If there is no objection, "(c)" will go out of the bill.

Senator SIMMONS. It is not altogether that way.

Senator SMOOT. It works both ways.

Senator SIMMONS. If there are any improvements, he would add them to the cost.

Senator SMOOT. That is true.

Senator SIMMONS. And if he suffers depletion, it goes off?

Senator SMOOT. Yes; that is true.

Senator SIMMONS. That is so clearly true, as Dr. Adams states the law of property, that it is not necessary to write it into the statute.

The CHAIRMAN. What is next? That will go out of the bill, if there is no objection.

Senator MCCUMBER. At this point, I would like to ask Dr. Adams a question on another subject.

Doctor, what objection would there be to taxing all interest paid in the United States to a nonresident and then not taxing interest paid by a nonresident alien to a nonresident?

Dr. ADAMS. There are some cases where the nonresident alien who pays interest does practically all of his business in this country. We have a number of such cases. That brings in the other point that I spoke of. Suppose a nonresident alien is doing practically all his business here, or a foreign corporation is doing practically all its business here, it is possible, in both cases, to shift the profits practically and in essence into interest form. That is very easy in many cases. That would exempt those profits if that were done.

We have importers, for instance, who are quite important ones and quite prosperous ones. We have private bankers who would go in the same group, who are also quite important and quite prosperous. They are usually partnerships. There is usually a resident partner who comes over here and may retain his citizenship. His own share is likely to be 95 per cent in this country. It would be quite easy to make a debt by which the true profits would be paid as interest. I suppose it was that consideration which led the Congress to change the old rule. That is the objection to your plan which I can see. I would be disposed to adopt your plan because of its simplicity, but that is the objection that leads to trouble.

Senator MCCUMBER. In other words, we make our law to meet a possible evasion and not to meet the situation as it ought to be made if there is not an evasion.

Dr. ADAMS. You understand, of course, that that is the present law?

Senator MCCUMBER. I understand.

Senator GERRY. Do we tax the resident aliens on income received from a foreign country when they are not in business?

Dr. ADAMS. We tax the resident alien on all income. The resident is really treated as a citizen.

Senator MCCUMBER. You asked me yesterday to draw up an amendment with respect to personal-service corporations. I thought I could draw it up. I stated that I thought I could at least draw an amendment that would indicate the kind of law that I thought would be equitable and would put the personal-service corporations on exactly the same footing in the matter of taxes that the partnerships would be on. I am not saying that this may not meet with objections on the part of those who want a different kind of rule, but I did draw up something which I think is simple and clear and will meet the proposition which I had in mind and to which I referred.

Senator GERRY. On what page is that?

Senator MCCUMBER. Line 10, page 70. My amendment begins after the word "corporation." We would insert there "other than a personal-service corporation." Then, after line 20, on page 70—the paragraph which fixes the tax of 15 per cent on the general corporation—insert the following:

"From and after the 31st day of December, 1921, personal-service corporations shall pay taxes upon their net incomes as follows:

"There shall be computed the proportionate amount of such net income which would be due each of the holders of stock in such corporation in case a dividend had been declared distributing the entire net income."

That is to determine what proportionate part each one would receive if he received it.

"There shall then be deducted from the moiety which would be due each stockholder had such distribution been made the sum of $2,500"—which is the highest amount you allow for a married man—"in case such moiety amounts

to $2,500 or over, or such portion of the said $2,500 as shall equal the amount of such moiety if less than said sum.

"There shall then be computed upon the balance, if any, of such moiety, after such deduction, a normal tax of 8 per cent, and in addition thereto a surtax upon such moiety, the several percentages set forth in section 221 (a)."

That is the surtax.

"The combined sums resulting from such computation upon each moiety shall be the tax due and collectible from such corporation and shall be in lieu of other Federal taxes.

"Whenever a distribution of the said net income of such corporation, or any part thereof, taxable as aforesaid, has been made, the amount received by the distributee shall be excluded in computing his income for taxation.

"The amount deducted from the moiety of each individual stockholder of a personal-service corporation in computing the tax upon the net income of such corporation shall, in the case of the individual holder of such stock, making a return upon his individual net income, be deducted from the credits allowed by subdivisions (b), (c), (d), and (e) of section 216 of this act, but not to exceed the amount of credits under said distribution to which the taxpayer would otherwise be entitled."

That simply makes the corporation pay exactly the same tax that an individual would pay if it were distributed, and inasmuch as you can not tell just what each individual would be entitled to in the matter of a deduction, being married or single, or having children, I took $2,500, which would be the highest, and then computed the taxes, the normal taxes, upon the other, and then provided that in case, in addition to this, the individual stockholder makes a personal return, that having already had the real benefit of the $2,500 rate, or so much thereof as his amount in the corporation would be, he can not deduct it a second time from his earnings.

I drew up several of these. I think this meets the situation in an understandable manner, but I would rather pass these around in order that Dr. Adams and members of the committee may examine them first.

Dr. ADAMS. I think, perhaps, Senator McCumber could help us all if he would tell us wherein his plan differs from the present plan of taxing personal-service corporations.

Senator McCUMBER. It gets exactly the same result, but avoids the decision of the Supreme Court, which held that, in substance, money received by a corporation should not be taxed against the individual until the individual had received it; and this is to meet those cases, of course, where there is not a distribution made. It provides that when the distribution is made, so that it will not be paid a second time to the individual, the distributive share that the individual received having paid a tax already, it will not be added to his gross income or to his net income.

Dr. ADAMS. Taking an illustration of a personal-service corporation with an income of $100,000 and distributing $75,000; what would you do with the $25,000 that year?

Senator McCUMBER. It distributes $75,000?

Dr. ADAMS. And holds $25,000. What would be done with that $25,000?

Senator McCUMBER. You have made your tax upon the full $100,000?

Dr. ADAMS. Under the existing law.

Senator McCUMBER. No; under this. The tax is upon the full $100,000 less deductions.

Dr. ADAMS. You put the tax on the corporation?

Senator McCUMBER. Yes; make the corporation pay it.

Dr. ADAMS. You say the corporation shall pay a tax equivalent to the personal income tax that would be paid if it were distributed?

Senator McCUMBER. That is it exactly; and when it is distributed it goes free to the individual and he does not need to make a return on it.

I wanted to speak of this also:

On line 10, page 70, after the word "corporation," insert "other than a personal-service corporation."

After line 20, page 70, insert the following:

"From and after the 31st day of December, 1921 personal-service corporations shall pay taxes as follows:

"A normal tax of 8 per cent upon the whole of the undistributed net income, and, in addition thereto, a surtax in the several percentages provided in section 211 (a) upon the net undistributed income."

Senator SMOOT. That would be the same thing.

Senator McCUMBER. It would not be exactly the same.

In most of these personal-service corporations about all the income that the individual stockholders receive is from that alone. They give their entire business to it, as a rule, or practically all their business. That is their income, I say in most instances. Of course, there would be many instances in which that would not be the case. By taking this method a person who would receive $50,000 outside and $50,000 from the corporation has the sum divided in two fifty thousands, and therefore he will not reach as high brackets. But stop right there a moment; think of the other side of it. Suppose that $50,000 is not distributed at all, or not more than $10,000 of it is distributed. Then he does not pay anything upon that $40,000. Is it not better to even divide it and get a proportion than to get nothing out of it because it has not been distributed? Because it has not been distributed you are not getting anything out of it.

I just want to submit that, and I thought I would first give it to the committee and then submit it to Dr. Adams.

Dr. ADAMS. There are questions of policy that you will have to decide, of course. For instance, start out with this very interesting and ingenious suggestion of Senator McCumber's. It starts with the notion that you have a kind of corporation that may relieve itself or its stockholders from taxation by not distributing. But any corporation which did not distribute would cease to be a personal-service corporation. That was the question of definition which I raised and seemed to be, perhaps, obnoxiously insistent upon. It would cease to be a personal-service corporation.

Senator McCUMBER. Why?

Dr. ADAMS. Because it is defined as one in which capital is not the material income-producing factor.

Senator McCUMBER. If a personal-service corporation does not need a penny of capital and makes a hundred thousand dollars it does not invest it. It still keeps it and goes on, and the next year it makes another hundred thousand dollars, but still has no capital invested——

Dr. ADAMS. I never knew them not to invest it.

Senator WATSON. Of course, they do not invest it in the business of the corporation. There may be several directors together, but they invest it in some way and receive earnings on it.

Dr. ADAMS. That is a simple point, Senator. You could correct that very easily.

Senator McCUMBER. They might simply deposit it as so much earnings and leave it in the bank.

Senator GERRY. They would get interest on it if they did. If they kept it for two years there would be $200,000 interest.

Senator WALSH. Is not that surplus rather than capital?

Dr. ADAMS. Not as your definition stands. It would take it out of the personal-service corporation class.

You could correct that very easily, but I think you have got to start with what was emphasized, as I say, somewhat obnoxiously the other day. I cited to you yesterday the firm of Price-Waterhouse. That is the best illustration you could possibly have. They have recently acquired a building in the heart of the Wall Street district costing a million dollars.

That particular point could be cured very easily by simply taking out one little feature of the personal-service definition. But a related question, which is one of policy which you gentlemen will have to answer, is this: Is not Senator McCumber's argument even more applicable to the man who has a lot of property, or to a group of men who have a lot of property, and are using that to escape taxation?

The first question of policy is, Do you want to adopt such a method, which is quite severe and strict and which is applicable to professional men earning money with their brains and which is not applicable to what is, to me personally, a very much more flagrant case, which is that of the man who has stocks and bonds which he inherited, perhaps, and who puts them in a corporation?

That is, to my mind, a far more important case than a group of engineers, and so on, because the average partnership in this country, gentlemen, and the average small personal-service corporation only earn about $10 000 income a year. That is all they get. They do not get anywhere near the 15 per cent rate. In other words, the average partnership would pay a very much heavier tax under the corporation tax than it would under the personal-service tax.

So it is evidently a certain class with which you are dealing, not only a group of accountants or engineers but the man who has a lot of money and, instead of getting interest on it and paying surtaxes on it, forms a little investment corporation.

The CHAIRMAN. Dr. Adams, we want to finish this bill on Friday. We have been discussing the personal-service corporation matter for three or four years. Can we not leave it to you to discuss it with Senator McCumber?

Dr. ADAMS. There is no use of leaving things to me that involve big questions of policy. I would simply make myself offensive.

The CHAIRMAN. We have discussed it for many years, and we would like to vote and finish the completion of the bill. I recognize the fact that it is important.

Senator SIMMONS. What is the fundamental objection to continuing the present provision that a personal-service corporation shall be taxed like a private one?

Dr. ADAMS. It is a constitutional one, Senator, that I was just referring to.

Senator MCCUMBER. The Supreme Court decision is the trouble.

Senator SIMMONS. The Supreme Court decision does not apply to a copartnership, does it?

Senator MCCUMBER. No; but it applies to all corporations who do not distribute.

Dr. ADAMS. The Senator was using a very ingenious means of trying to find out about what the tax would be if it were on the partnership basis and then placing that tax on the corporation. That can be done in a number of ways, and if you gentlemen will settle the big questions I will confer with the Senator and try to work this out.

Senator MCCUMBER. Let me ask you one question right there. If several attorneys get together and form a corporation and make a hundred thousand dollars in a year and draw $25,000 and invest the other $75,000 in real estate loans or in any kind of business such as buying Liberty bonds, for instance, do they cease to become a personal-service corporation?

Dr. ADAMS. Not merely in one year, but if they went along a few years more——

Senator MCCUMBER. Why should one year make any difference, if it is to be determined by whether or not they invest and have capital invested? Suppose the capital were such that it does become quite material; say they have $100,000 invested the first year and it is bringing 4½ per cent. It would amount to quite a little. I want to know whether that converts it into a business corporation or whether it still continues a personal-service corporation?

Dr. ADAMS. As soon as a material part of their income comes to be derived from capital they cease to be a personal-service corporation.

Senator MCCUMBER. A material part. Do you determine it by percentages?

Dr. ADAMS. That is the law.

Senator MCCUMBER. I know; but in applying that law you must apply it on some kind of a percentage to determine what is material.

Dr. ADAMS. For instance, if a group of lawyers kept enough capital to pay incidental court fees and to advance their stenographers' wages and to buy a few law books and stationery, that is incidental to the law business. If, on the other hand, they stack up a surplus of $100,000 or so, we hold that it is not incidental, but becomes material—a material income-producing factor. That is the language of the law, as you recall. A personal-service corporation can only be one in which capital is not a material income-producing factor.

Senator MCLEAN. Do you propose to put a surtax on the amount withheld from distribution?

Senator MCCUMBER. Yes; on the whole thing.

Senator SIMMONS. As a matter of fact, practically all of the earnings of personal-service corporations are distributed, are they not?

Dr. ADAMS. Sometimes they are and sometimes they are not. That is the real reason I want to get rid of this, because of the great difficulty. Douglas Fairbanks is incorporated; Mary Pickford is incorporated. A very prominent gentleman, whom I shall not name, but who is a genius in a particular line, is a personal-service corporation and has accumulated four or five hundred thousand dollars capital. His genius made that business. It would be the purest kind of a personal-service corporation if it did not have some capital in there.

Take an advertising agency. It can be run without any capital. This man whom I mentioned is an advertiser. He is a genius at advertising. He can run a business without a dollar's worth of capital. Suppose a man had a couple of hundred thousand dollars. He could go out to another man who wants to do

some advertising and say, "Let us do your professional advertising work for you. We will finance it, and if you do not get returns for it you do not have to pay."

The same thing is true in the commission business. The commission business can be run without capital, but if you can get capital you can tie your customers to you. Take the cattle commission business. It has become almost necessary to have capital, in order to help farmers out with feed during the winter.

So that you find in every business a subtle way of using capital, or when you do not find it you invest it. So it is the easiest thing to get out of the personal-service class. Up to the present time it has been desirable for people to get into it, but the moment it becomes advantageous to get out there will not be the slightest difficulty in doing so.

That is the reason I wanted the definition changed.

Senator McCUMBER. Take your illustration of Douglas Fairbanks and Mary Pickford. If they were in partnership they could pay, under the present law, up to 65 per cent of their earnings as taxes, but if they put their two earning capacities together in a corporation they will never have to pay over 15 per cent of their earnings. That seems so everlastingly unjust, where their earnings are so enormously beyond what they need to use and will use for their personal expenses, that there ought to be some way to tax them the same as a partnership.

I think you can work something out of it.

The CHAIRMAN. Doctor, we were hoping to avoid discussion by referring it to you.

Dr. ADAMS. I know, Senator, but I can not draft diametrically different things. I want to save time, of course——

The CHAIRMAN. You have the views expressed, Dr. Adams. Those views and principles are referred to you.

Dr. ADAMS. Very good, sir.

The CHAIRMAN. My mind is in some confusion as to what they are, Doctor.

Dr. ADAMS. The truth is that the committee is fundamentally divided.

The CHAIRMAN. I think the committee will be satisfied with your final verdict, and I suggest that you confer with Senator McCumber and Senator Simmons during the process of incubation, and the committee will proceed to the next subject.

Dr. ADAMS. Very good. On page 32, sir, I have a number of small amendments.

Senator CURTIS. I thought that yesterday we authorized the doctor to make any of these small amendments that were found necessary.

Dr. ADAMS. They are absolutely mechanical.

The CHAIRMAN. That was agreed to. We have got to be a little heroic on this thing. This is open to change on the floor and will be changed on the floor.

Dr. ADAMS. Here is a question on page 39 that must be brought before you gentlemen.

You have a provision in the existing law relating to discovery depletion. That is to say, a corporation ordinarily computes its depletion on the basis of cost, but if it purchases its property before March 1, 1913, it computes its depletion on the March 1, 1913, value, but if it discovers a mine or an oil well after March 1, 1913, it is entitled to compute its depletion on the value of that mine or oil well within 30 days after discovery.

Cases of this kind are getting rather frequent. The department is worried about it, and we want your judgment upon it.

I give a typical case. A corporation which has been engaged for years in the street-railway business was rather prosperous and went into the oil business. They brought in a well, a gusher, a very fine well, in a district where values were exceedingly high, and they got an enormous discovery value. Their depletion allowance at that time based upon this discovery value was something over $1.50 a barrel, because the value was so high, but with the passage of time the oil itself ceased to be worth $1.50 a barrel.

Their contention now is that a depletion deduction of more than the entire gross price that their oil is selling for in effect reduces the earnings from other lines of the business; in other words, they have a loss now, based upon this discovery depletion, which is charged against their earnings from their street railway and power enterprises.

This amendment has been suggested, about which I make no recommendation. It is to go on page 39, at the end of line 25:

"*And provided further*, That such depletion allowance based upon discovery value shall not exceed 50 per cent of the operating profit from the property upon which the discovery is made, except where such percentage of the operating profit is less than the depletion allowance as based on cost or fair market value as of March 1, 1913."

I bring this in with great hesitation. It is a delicate subject, and I want your counsel and direction rather than to make any suggestion.

Senator SMOOT. Do I understand that whatever the operating expenses of a mine are they can only have 50 per cent of the operating expenses for depletion?

Dr. ADAMS. No; operating profit. For the discovery depletion it can not go beyond that. If they have an operating loss, they can not take depletion. It is no good to them.

Senator SMOOT. I was thinking of a mine as against an oil well. In an oil well the operating expenses are very, very much less than in the case of a mine, and there would be a discrimination between those two classes of properties. As soon as the oil comes up it is forced into barrels and there is very little expense to it, whereas in the case of a mine you have got to mine your product and lift it and handle it in a dozen different ways before ever you get it onto the cars, and from there to the smelter. It is quite a different proposition; and this is supposed to apply to both. Are you limiting both of them to 50 per cent?

Dr. ADAMS. Ought you to get for discovery value more than 50 per cent of your profit? The trouble arises here. It comes on this question of valuation which I am always trying to avoid. I never was in favor of this provision. I think it is a bad provision of law. I think we ought to give a good, generous, fixed arbitrary depletion allowance based on valuation.

Here is what happened in this particular case: This company brought in a big gusher in a district where the values were very high and the district was in the flush and fever of speculative values. It had to be valued within 30 days, and that one oil well got a valuation two or three times as much as it was worth six months later, and ten times as much as it is worth now.

The consequence is that they have a perfectly enormous valuation. It is really too big. I think that the company would say that it is almost excessive, simply because they got it valued in that 30 days. They are not only taking half or more of their operating profit; their depletion takes out all operating profit, every dollar; and not only does it do that, but it goes beyond and calls for some of the street railway and power profits.

Senator SMOOT. That can happen only in an oil well. That could not happen in a mine unless you find solid gold and take it out within a few months, and that never happens.

Dr. ADAMS. The discovery proposition is not so important with respect to mines. There are not so many discoveries made there. It is mostly important in the oil end of it. You do not have many discoveries in mines.

Senator SMOOT. No; because metals are so low that they are not making very much out of it.

Dr. ADAMS. First of all, is the proposition as I put it too rigid; too rigorous? I am not talking about depletion on March 1 value, but depletion on cost.

Senator WATSON. How many cases of that kind have you run across?

Dr. ADAMS. Very many. This is not a stray case. It is getting to be very important as the price of oil falls.

In the first place, would it be too rigorous? In the second place, ought we to do something to prevent the charging off of a loss based on depletion value against profits from an entirely distinct end of the business; and, in the third place, had we better do anything with it?

Senator LA FOLLETTE. Why can they not be separated, Doctor?

Dr. ADAMS. That is the point. We could get the income from the public utility business and from the oil end and keep them separate.

Senator CURTIS. It seems to me that is the proper way to do it.

Dr. ADAMS. Very well I will not bother you with it.

I have nothing more on the income tax title this morning that I can bring to you at this time.

Senator DILLINGHAM. Dr. Adams, a gentleman handed me this proposed amendment in connection with the tax on golf goods and says that embodies what you have ruled. He is a manufacturer, and he says that embodies what the department has ruled in his negotiations with you. He thinks he makes it a good deal plainer than the text. I wish you would look it over.

Dr. ADAMS. I will, sir.

Now we come to the excess-profits title, and I have no recommendations to make on that at this time except that Mr. Beaman, Mr. Walker, and myself be authorized to take out the material which is obviously superfluous.

For instance, there are a lot of old rates superseded. For example, line 5 on page 117, "30 per cent of the amount of the net income in excess of the excess-profits credit," and so on. It has got to stay there for a year now.

I take this occasion to say to you that you can not have a simple act with a lot of stuff in there for one year only. I am disappointed myself from that standpoint, but that is a question of policy. You have some rates applicable only for the year 1918. The 80 per cent rate is in there. You do not want to repeat that, I take it.

In lines 12, 13, 14, and 15, as an illustration, you have a bracket providing:

"The sum, if any, by which 80 per cent of the amount of the net income in excess of the war-profits credit (determined under sec. 311) exceeds the amount of the tax computed under the first and second brackets."

That was confined to the year 1918. We want to omit that.

Again, section 302. All of it will go back except that kind of thing. You have got to put all this Title III back into the bill, but all those unnecessary things should be stricken out. The excess-profits title will have to stay in the bill for one year, but that excess-profits title has a lot of extraneous matters that relate only to the year 1918. The latter part we ought to be authorized to take out, illustrated by the section I just read.

Senator WATSON. I move that the doctor be so authorized.

Senator CURTIS. I second the motion.

(Agreed to.)

Dr. ADAMS. Now, coming to the estate taxes, page 138——

Senator CURTIS. Doctor, could you not raise the amount on some of those higher brackets and raise some money and not do very much injustice and afford some relief as to those smaller taxes?

Dr. ADAMS. Senator, that would be the most hard-fought question that has come up. That is a question altogether for you gentlemen, not for me at all.

(After informal discussion.)

May I ask that the estate tax go over? Let us take up the next title.

Senator SMOOT. Page 155, "Tax on transportation and other facilities."

Dr. ADAMS. You have got to settle on that. That is a major question. Telephone, telegraph, oil, express, and insurance were left over until a scheme of taxation could be worked out. The Republican members decided to abolish the tax on freight transportation and passenger transportation.

The CHAIRMAN. What taxes were abolished, in your opinion?

Dr. ADAMS. The Republican members decided on the freight and passenger taxes.

The CHAIRMAN. Did we decide to abolish them entirely?

Dr. ADAMS. That was the decision of the Republican members—after January 1, 1922.

Senator MCCUMBER. To bring the matter before the full committee, I move that taxes on transportation of persons and property be eliminated after January 1, 1922.

Senator WATSON. Does that leave in the Pullman tax?

Senator MCCUMBER. No; that is included in transportation.

The CHAIRMAN. Mr. McCoy sends word to me through Mr. Walker that we will be short of revenue if we take the tax entirely off transportation of freight and passengers.

What have you to say on that, Mr. McCoy?

Mr. MCCOY. I understood the agreement was—and my computation is made on that basis—that the tax would be cut in half on the 1st of January, 1922, and that it would be taken off altogether on the 1st of January, 1923.

The CHAIRMAN. Does that satisfy you, Mr. McCumber?

Senator MCCUMBER. No; I think we ought to relieve transportation. A transportation tax is the worst form of taxation. I think we ought to relieve it immediately—that is, after January 1—and then find some other method to make up the difference, whatever it may be.

Senator WATSON. What is the other method?

Senator MCCUMBER. I do not know now, but undoubtedly a method will be found.

Senator WATSON. What is the amount involved, Mr. McCoy?

Mr. MCCOY. $131,000,000.

The CHAIRMAN (after informal discussion). I will move to amend your motion, if you will permit me, to make it 50 per cent.

Senator MCCUMBER. I will consent to that. Let it be 50 per cent until the year 1923.

(The motion was agreed to.)

The CHAIRMAN. All those in favor of retaining the tax on express and pipeline transportation will raise their right hand. [After a vote was taken.] It is agreed to unanimously, apparently.

Dr. ADAMS. Passing over the insurance matter, we come to page 190——

Senator CURTIS. What about beverages?

Dr. ADAMS. There are only two slight amendments.

Senator CURTIS. Why can we not increase the tax in line 20 from $2.20 to $4.20?

Dr. ADAMS. That is page 165.

Senator CURTIS. The tax is $2.20, "or, if withdrawn for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $6.40." Why can we not make that tax $4.40? What effect would a tax of $4.40 have on the revenue?

Dr. ADAMS. Mr. McCoy can answer that very much better than I can.

Mr. MCCOY. It might save a little revenue, but it would cost the people a good deal more. This tax is on all alcohol used in business. There are lots of medicines and many preparations made with alcohol of which there is not one trace left after the thing is finished.

Senator CURTIS. Where can we put it in this beverage proposition?

Mr. MCCOY. There is no beverage alcohol used in the United States now, legally.

Senator CURTIS (after informal discussion). I withdraw my amendment.

Dr. ADAMS. The next is page 176, lines 7 to 13:

"The process of extraction of water from high-proof spirits for the production of absolute alcohol shall not be deemed to be rectification within the meaning of section 3244 of the Revised Statutes, and absolute alcohol shall not be subject to the tax imposed by this section; but the production of such absolute alcohol shall be under such regulations as the commissioner, with the approval of the Secretary, may prescribe."

That is to permit absolute alcohol to be made without suffering a rectification tax, under close regulations by the department.

Senator SMOOT. They would have to be pretty close.

Dr. ADAMS. The next change is on page 190, and it raises the question of beverage taxes on nonalcoholic beverages. It begins with line 6.

First of all, on cereal beverages you have your proposed tax of 4 cents a gallon.

Senator SMOOT. That is $1.24 a barrel. The old rate was $1 a gallon.

Dr. ADAMS. You mean before the war?

Senator SMOOT. Yes.

Dr. ADAMS. It went up very much beyond that during the war. We did not have any of these taxes before the war.

Senator MCCUMBER. Why should we have such a small tax as 4 cents a gallon?

Dr. ADAMS. Mr. McCoy can explain that.

The CHAIRMAN (after informal discussion). Why was this done, Mr. McCoy, and what is your view on it?

Mr. MCCOY. The reason the House changed the rate from 15 per cent to 4 cents a gallon was that the 15 per cent was based on the selling price. A great deal of this stuff was made in the interior and shipped thousands of miles and sold by the manufacturer. The 15 per cent was collected on the freight rate and packing in addition to the cost of the product, and the sellers complained very bitterly. The Treasury could not get around the law, and it advised them to form selling corporations and sell the material where it was made. They did that, and the Treasury claims that they are evading the law.

Dr. ADAMS. Mr. McCoy, I do not like to think the department was doing that unless it is pretty well substantiated. Do you think that is well substantiated?

Senator CURTIS. My recollection of the testimony is that the Treasury Department asked them why they did not have selling companies, and they took advantage of that, and then they all organized selling companies.

Mr. MCCOY. Some have the same concerns as selling companies that they had when they were manufacturing beer. This cereal beverage must not be confused with beer, because there is no alcohol in it. It is a temperate beverage

the same as sarsaparilla or ginger ale or anything else or that kind, and should be on a parity with those things, although it costs more to manufacture a cereal beverage than it does any of these other bottled goods.

The cost of manufacturing cereal beverages is greater than the cost of manufacturing beer in two respects. In the first place, most of it is brewed just like the old-fashioned beer, and then the alcohol is removed. Then there is a further charge in this bill. They charge it with carbonic acid gas which is taxable at 5 cents a pound. So that is an additional tax in the manufacture of this cereal beverage.

Senator DILLINGHAM. To what extent does the alcohol that they extract from it decrease the cost of it?

Mr. MCCOY. It does not decrease it very much. It is sold generally in the course of the trade. It pays this $2.20 a gallon tax.

Senator GERRY. They sell the alcohol separately?

Mr. MCCOY. They can; yes, sir. The alcohol is sold. It is a by-product; but there is not as much by-product from the manufacture of cereal beverages as there is from yeast plants. They get more from the alcohol than they do from the yeast.

Dr. ADAMS. Is it not true that some throw away the alcohol because it does not pay them?

Mr. MCCOY. Some say they do. I do not think they would throw it away if they could get any money from it. Some claim they do throw it away.

One trouble is that it is manufactured generally by manufacturers who used to make beer. They are trying to keep their plants and their employees going. They are somewhat overcapitalized, and until they get large production they can not manufacture it economically. I saw the books of one of the larger concerns, and they have lost steadily. They can not keep it up. The revenue this year has fallen off very much from cereal beverages. Four cents a gallon is really higher than 15 per centum.

Senator SUTHERLAND. Will it actually net more revenue?

Mr. MCCOY. It will either net more revenue or kill the business.

There is one thing that these near-beer beverages have to compete with, and that is the "home-brew." There is no doubt about that. Home brew is made very much, and it is increasing diabetes in this country to a very considerable extent. It is a very unhealthful thing and is hurting the health of the people, especially the working people.

Cereal beverages, under the House bill, will produce about $12,000,000.

Senator SMOOT. In paragraph (c) there is a question that has not been decided; that is, as to whether you want to exempt table waters. In other words, you have still drinks 3 cents a gallon, and table waters that are higher priced than still drinks are taxed nothing.

The CHAIRMAN. Why should they be exempted?

Senator SMOOT. That is what I wanted to decide.

The CHAIRMAN. Let us cut the exemption out.

Senator MCLEAN. What shall we do with subdivision (d)?

Senator MCCUMBER. There is a heavy complaint all over the country which comes to me particularly from my own section against the tax that is now imposed upon the bottlers of pop and ginger ale, etc., the kind they sell for 5 cents a bottle. They can not sell it for anything more than that without diminishing their sales enormously. Is there not a way to exclude that?

The bottlers made this report to me, and I put the question up to them: "Is it not satisfactory to you if the tax is made as in the House upon the sirups and upon the carbonic acid gas?"

They said, "No; because the tax is so high upon those that we can not make a profit and sell our product at the old rate of 5 cents a bottle. When you get it above 5 cents a bottle you can not tax it against the consumer, because he will not buy it."

Mr. MCCOY. This reduces the tax very much on bottle goods. It will be less than one-fifth of a cent a bottle, while at the present time it is nearly three-quarters of a cent on a 5-cent bottle.

Senator WATSON. How much revenue do you get on that?

Mr. MCCOY. Under the present law we get about $41,000,000 on the fruit juices and soft drinks, outside of cereal beverages.

Senator SUTHERLAND. What is the rate in the present law?

Mr. MCCOY. Fifteen per cent; 10 per cent on those drinks and 15 per cent on cereal beverages.

The CHAIRMAN. What will we get under this?

Mr. McCoy. Twelve million dollars. We are losing the difference between twelve million and forty-one million.

Senator McLEAN. What does the revenue on the sirup amount to?

Mr. McCoy. Instead of taxing the sirups the extract was taxed. The extract must be made by the manufacturer. Extracts are never made by the druggist or anyone that makes the sirup. So, if you tax the extract and the carbonic acid gas, you catch the whole thing.

Senator WATSON. How much revenue do we get from the soft drinks?

Mr. McCoy. Nineteen millions from the cereal beverages and forty-one millions from the other soft drinks. Under the House proposal we get eighteen millions from cereal beverages, two millions from the carbonic acid gas, and twelve millions from the soft drinks.

Dr. ADAMS. The soft drink people and the bottled drink people complain that they can not shift the tax. I would like to emphasize that, because if you will go through this bill you will find a great many cases where the tax can not be shifted.

Mr. McCoy. The soda fountain shifts it.

Senator SIMMONS. How much do you get from a tax on table water?

Mr. McCoy. That has always been a very low tax. You get a couple of millions from that, from the plain table water. Then there are Apolinaris and White Rock, and those sparkling waters that we would get more from.

The CHAIRMAN (after informal discussion). Suppose we make them all 4 cents per gallon?

Senator McCUMBER. Take (c), for instance: "Upon all still drinks, containing less than one-half of 1 per centum of alcohol by volume, intended for consumption as beverages in the form in which sold (except natural or artificial mineral and table waters and pure apple cider"—which would include those which have no alcohol—"a tax of 3 cents per gallon."

The CHAIRMAN. Why should they not pay 4 cents like a cereal beverage?

Senator McCUMBER. I think it is too high.

The CHAIRMAN. Mr. McCoy says it is too low.

Senator McCUMBER. Take (d):

"Upon all finished or fountain sirups of the kinds used in manufacturing, compounding, or mixing drinks commonly known as soft drinks, sold by the manufacturer, producer, or importer, a tax of 10 cents per gallon; except that where any person manufacturing carbonated beverages or conducting a soda fountain, ice-cream parlor, or other similar place of business manufactures any sirups of the kinds described in this subdivision there shall be levied, assessed, collected, and paid on each gallon manufactured and used in the preparation of soft drinks a tax of 10 cents per gallon."

It seems to me that is a pretty heavy tax.

Dr. ADAMS. That is on these highly concentrated drinks. While I do not know as much about it as Mr. McCoy, the soft-drink bottling industry is not prosperous. It is in bad shape. They had a flush time during the war. It is an easy business to go into, and lots of people went into it. Since the war has ceased they are almost forced to reinstate the 5-cent drink, and at least to my mind they have made a rather convincing case that they are in rather bad shape. I can not speak with any expert authority on that, but they have been to see me and presented figures which tend to show that they are in bad shape and that they can not raise their prices.

Senator DILLINGHAM. Which ones?

Dr. ADAMS. The pop people and sarsaparilla people, and so on.

Senator CURTIS. They have got to furnish the bottle and lose the bottle.

Senator McCUMBER. Those are the people that I want to help out.

Senator CURTIS (after informal discussion). Going back to (c), why except artificial mineral waters?

Senator SMOOT. That is a question that went over.

Senator McCUMBER. They charge as much as the price of near beer. Why should they not pay a tax?

Dr. ADAMS. Sometimes the water supplied by a city is impure or bad, and every householder has to buy water.

I think one of the experts from the department recommended that this be done because the yield on the present tax on artificial mineral and table waters is so small.

Is it separately shown in the statistics, Mr. McCoy? I think Mr. Bush said there were only three or four hundred thousand dollars a year, altogether.

Mr. McCoy. About a million dollars.

Dr. ADAMS. You want to keep in that limit—"when sold for over 10 cents a gallon."

Mr. MCCOY. Apollinaris, White Rock, and so on, which are aerated waters, sell for about the same price as near beer and fruit juice.

The CHAIRMAN. What do you suggest, Dr. Adams?

Dr. ADAMS. If you are going to have it taxed at all, that you put back artificial mineral and table waters selling for more than 10 cents a gallon.

Senator SUTHERLAND. What do they pay now?

Dr. ADAMS. Two cents a gallon if selling for more than 10 cents.

The CHAIRMAN. If there is no objection, that will be done.

Senator SUTHERLAND. Is it your idea, Mr. Chairman, that it goes back to the present rate?

The CHAIRMAN. Yes. How about these still drinks as compared with cereal beverages? Why should they not be on an equality?

Dr. ADAMS. Because in (b) they are paying the same tax indirectly through the ingredients. The still drink has no carbonated gas in it. The gas is paying a tax and will fall on the man who makes the carbonated beverage.

The CHAIRMAN. You think it is all right, do you?

Dr. ADAMS. With this one exception: Yesterday I found on my table a memorandum from the head of the sales-tax division, who is an expert on this matter, saying that there ought to be some slight change, a very small one, in these rates of 2 or 3 per cent. I sent for him to come down before the committee, but I find that he is sick.

The CHAIRMAN. When can you report, Doctor?

Dr. ADAMS. On that particular point, to-morrow. If you adopt it I would like you to adopt it subject to some further report.

The CHAIRMAN. Let it be agreed to, subject to modification when Dr. Adams makes his report.

Senator SMOOT. That takes us over to the tax on cigars and tobacco.

Senator MCCUMBER. I suggest that we take a recess until 3 o'clock.

The CHAIRMAN. The committee will take a recess until 3 o'clock this afternoon.

(Whereupon, at 1 o'clock p. m. the committee took a recess until 3 o'clock p. m.)

AFTER RECESS.

The CHAIRMAN. The committee will resume its proceedings, and Dr. Adams will continue his interesting statement.

Dr. ADAMS. As I understood it, we had reached the tax on cigars and tobacco, on page 199. You did mention a little thing in subdivision (b) of 629. That does nothing [reading]: "Each person required to pay any tax imposed by section 628 shall procure and keep posted a certificate of registry," and so on.

The CHAIRMAN. That is agreed to.

STATEMENT OF HON. CLAUDE A. SWANSON, SENATOR FROM VIRGINIA.

Senator SWANSON. In section 1002 of the present revenue bill you provide a special tax to be imposed in that section which puts a license on tobacco, cigars, and cigarettes made entirely for export. Under section 6 you have certain people take out a license to do an export business; they can not sell anything in this country. They do a big export business; they have two factories in Petersburg and one in Richmond engaged entirely in export business abroad.

What they want to do is simply to amend section 1002 so that everything that is limited absolutely to cigars, cigarettes, and tobacco for export shall pay that tax. That has been done universally, and this was an oversight that they failed to put that exemption in there. They said all persons who manufacture should pay a certain license tax, and do not exclude those who do an exclusively export business. They want to say: "*Provided*, That the special tax imposed by this section on sales, and then shall not apply in respect to such articles sold for export and in due course are exported.

The CHAIRMAN. What have you to say about this, Dr. Adams?

Dr. ADAMS. The Senator has explained it. You have there a license tax that is adjusted to the amount of the sale.

The CHAIRMAN. Do you recommend it?

Dr. ADAMS. The Treasury Department does not recommend it. On the whole I think it is a sound claim. There is doubt about the constitutionality of the law as it stands.

Mr. MCCOY. It only brings in $1,500 a year.

Senator SWANSON. The tax is small, but these people have already gone to China, to India, and other places, and they say if this Government is going to start a policy of not allowing the export business free they will have to discontinue manufacture here. You have always had an invariable policy of saying that everything in that bill where it is exported does not have liability.

Senator SMOOT. We imposed a tax on all steel products where exported.

Senator SWANSON. I have a memorandum where you excluded from tax under article 6 where you engaged in nothing but exclusively export business. You have under section 6, where a man gets out a license to do nothing but exclusively an export business exempted him. We do nothing else but make tobacco, cigars, and cigarettes to sell abroad, and if this is not the policy of the Government we do not like to enlarge.

Dr. ADAMS. The articles manufactured for export are not taxable.

Senator SWANSON. When a factory makes cigars or cigarettes for export they take out a license for export business and they can not sell one thing here.

Senator SMOOT. Then they ought not to pay any tax.

Senator SWANSON. All they want to do is to put that exclusion in there.

Senator MCCUMBER. It was suggested to me that we include some additional sections; that is, have it cover it by a certain title in other sections.

Mr. MCCOY. If we amend on page 281, subdivision (c) [reading]: "(c) Under such rules and regulations as the commissioner with the approval of the secretary may prescribe, the taxes imposed under provisions of Titles VI, VII, or IX"—that is, beverages, tobacco, and excise taxes—"shall not apply in respect to articles sold or leased for export and in due course so exported."

If you add, on line 21, after "IX," and "and section 1002 of Title X."

The CHAIRMAN. Is there any objection?

Mr. WALKER. Subdivision (c) only applies to taxes upon articles, while this is a special tax upon the privilege of doing business.

The CHAIRMAN. Is there any objection to the experts drafting this in response to the suggestion of Senator Swanson?

Senator MCCUMBER. I understood that that addition would cover it, but Mr. Walker says no.

Dr. ADAMS. It is a license tax on the privilege of doing business based on the amount of sales.

We now return to the title dealing with tobacco, which has not a single amendment connected with it. There is no amendment until you come to Title VIII, taxes on admissions and dues, and the change at the bottom of page 209 is to abolish the tax on free admissions as now imposed and partial price admissions. It has been a nuisance, because the ordinary ticket is not sold to the people, and so the department recommends its abolition [reading]:

"In the case of persons (except bona fide employees, municipal officers on official business, persons in the military and naval forces of the United States when in uniform, and children under 12 years of age) admitted free or at reduced rates to any place at a time when and under circumstances under which an admission tax is made to other persons, a tax of 1 cent for each 10 cents"—

You are taxing free admissions, but you have a lot of exceptions to it already. The department was under the impression a very trivial revenue was involved.

The CHAIRMAN. It is agreed to.

Senator WALSH. Are you not thereby putting a tax on children under 12 years of age?

Dr. ADAMS. They stand in the same position whether the provision is retained or stricken out. The next is in line 18, page 210, where you have "and subject to the penalties and interest"—you are applying some penal statutes by reference. It is necessary when doing that by reference to mention specifically the penalties.

The CHAIRMAN. The draftsmen will fix that properly.

Dr. ADAMS. The same thing with respect to line 1, page 211.

Then you come to page 212, and you have the amendment relating to agricultural fairs, and so on.

Senator MCCUMBER. I would like the committee to consider this: Amend the present provisions by adding at the end of article 512, page 155, of printed

regulations No. 45, edition of 1920, revenue act of 1918, promulgated January 28, 1921:

"The exemption for agricultural fairs where the receipts are used exclusively for upkeep and operation shall apply both to the main gate receipts and to receipts of all exhibits, entertainments, and other pay features within the grounds where said exhibits, entertainments, or pay features are conducted by the fair organization or association. The gross receipts from operation are handled direct by the fair association conducting same."

Dr. ADAMS. I think that is all in here; I think this [indicating] is the same thing.

The CHAIRMAN. We had that very thoroughly discussed three years ago.

Dr. ADAMS. I would like to change the language, "None of the profits of which are distributed to members of such organizations, or exclusively to persons in the military and naval forces of the United States, or admissions to agricultural fairs none of the profits of which are distributed to stockholders." Change that to the language used in lines 10 and 11: "If no part of the net earnings thereof inures to the benefit of any private stockholder or individual."

The only reason for that is that this is old language which has been thoroughly interpreted, whereas "the profits of which are distributed to stockholders or members of the association conducting the same" has not been so frequently interpreted.

The CHAIRMAN. It will be changed.

On page 213, in paragraph (d), we want to make it, as a matter of administration, the price of admission will be printed on part retained not by the management but by the administrative authorities.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. You come now to excise taxes, section 900, and you want to look at this not for final form but substance. The first amendment which we come to is in paragraph 3, page 215. This was an amendment proposed by the department to benefit the manufacturers by avoiding double taxation. The manufacturers now say they do not want it, and prefer to stay under the existing law. So I ask you to withdraw that and not concur in paragraph 3. This is the whole question: The tax applies to parts of parts of automobiles sold. We do not want it to apply to parts of parts when the part is eventually going to pay the tax. We do not want them to pay twice. The thing is terribly mixed and involved, and in order that it should be perfectly apparent that it was not to apply to the part of a part, particularly when that part was going to be sold later as a part of the finished automobile, we suggest the change. The automobile manufacturers themselves say they are satisfied with the regulations which do this same thing, and they do not think that this language particularly accomplishes that result.

The CHAIRMAN. You think it does?

Dr. ADAMS. The department thought so before. We say, leave the law as it is and refuse to concur.

The CHAIRMAN. That is agreed to.

Dr. ADAMS. There is no change in paragraph 4 except "player pianos."

The CHAIRMAN. That is agreed to.

Dr. ADAMS. You come now to paragraph 5. In sporting goods the rate has been cut in half.

Senator CURTIS. By restoring nearly all the tax on the articles in the House bill could we produce enough revenue to relieve those bottle people?

Dr. ADAMS. There would be a loss of $3,000,000.

Senator CURTIS. I understand furs have been put on the free list.

Dr. ADAMS. The tax was cut in half.

Senator CURTIS. The House has cut out those, but they have reduced the tax on the things they leave in one-half. By doubling that and putting it back where it was, could we get enough to relieve the bottle people? Suppose we put the whole thing right back?

Mr. MCCOY. You will get four million.

(It was agreed to restore to the taxable list by vote of 6 to 5.)

Senator CURTIS. Then I move to disagree upon the rates, and instead of 5 per cent make it 10 per cent.

(Disagreed to by vote of 5 to 4.)

(The committee thereupon by vote agreed to 5 per cent.)

Senator MCCUMBER. I move to strike out 3 per cent on chewing gum.

Senator CURTIS. How much does that raise?

Mr. McCoy. $300,000. The trouble with chewing gum is that it is made in certain sized package. It is put through machines to a certain extent, and they can not make it any smaller, even if they sell it in penny sticks, and they are having such difficulty that they can not pass the 3 per cent tax along and they are paying it, and the result is that there are only one or two plants running; their plants are shut down; they are losing money, all of them.

Dr. ADAMS. Some raised their price during the war and others did not. The Beechnut gum people raised their price.

Mr. McCOY. The tax collected in July, 1920, on chewing gum was $283,000; on July 1, 1921, one year after, it had fallen to $172,000, a fall of over $100,000, almost 50 per cent.

Senator GERRY. Has chicle raised in price?

Mr. McCOY. Not to amount to anything. It is much higher than prewar.

(The motion to make the rate on chewing gum 1 per cent was carried.)

Dr. ADAMS. I am now referring to line 14—10 per cent on cameras, and we have added "and lenses for such cameras."

Mr. McCOY. There is obtained $800,000 from cameras.

Dr. ADAMS. They are the one people who never asked to have taxes reduced.

The CHAIRMAN. Without objection, we will allow it to stand as it is.

Dr. ADAMS. Candy is the next item.

Senator DILLINGHAM. I have several communications from people whom I know, and they say that reliable statistics show that 80 per cent of all candy is sold by the manufactures at prices under 20 cents a pound.

Senator LA FOLLETTE. Is not this a tax that is evaded by Greeks, Italians, and others?

Mr. McCOY. Yes.

The CHAIRMAN. How much revenue is produced?

Mr. McCOY. The present law brings in $22,000,000; the proposed reduction would bring in $14,000,000.

Senator MCCUMBER. I move that that which is sold for more than 50 cents a pound, including the container, shall bear a 10 per cent, and put the rest of them at nothing.

Senator CURTIS. Why not make your motion applying to all candy 40 cents a pound and above?

Senator MCCUMBER. All right; make it 40 cents, including container.

The CHAIRMAN. How would that cover it, Mr. McCoy?

Mr. McCOY. Candy is being sold in this city at $1.50, and it does not cost over 20 cents a pound to make, by the manufacturer. Many of the candy makers are manufacturing concerns, and sell directly to the retailers. The great drop in sugar has been a safety valve in the candy business. I know of an instance where a manufacturer had contracted for an immense amount of sugar at 26 cents per pound, and when the price came down to 7 cents a pound he turned that sugar into candy and made 100 per cent out of it. In the case of the higher-priced candy, the retailer is the manufacturer.

Dr. ADAMS. There is not enough candy sold wholesale above 40 cents a pound to make it worth while to vary it.

Senator DILLINGHAM. What would you say about lowering that?

Dr. ADAMS. That is for you gentlemen to say. The great mass of the cheap class of candy sells around 20 to 25 cents a pound, wholesale, does it not, Mr. McCoy?

Mr. McCOY. Very fine candy is sold at 25 cents a pound.

Senator MCCUMBER. Why not have it "sold for retail at so much"? Most of the manufacturers are also retailers.

Mr. McCOY. I should think it might be "sold to the manufacturer" whether retail or wholesale. If he sells at retail, he is making a bigger profit, and he can afford to pay the price.

Senator DILLINGHAM. I move that we adopt the House amendment.

Senator MCCUMBER. I move an amendment to that, in the form of an addition: "*Provided*, That candy sold at 40 cents per pound or over, including container, shall be taxed at 20 per cent"—whoever sells it.

(Senator McCumber's motion was carried 6 to 3.)

Dr. ADAMS. There is no change until we come to portable electric fans, which has been exempted, line 3, page 217.

Senator LA FOLLETTE. How much revenue do we get from paragraph 10, firearms, shells, and cartridges?

Dr. ADAMS. It is a pretty good yielder.

(The motion to make rate on firearms, shells, and cartridges 10 per cent was not agreed to, by vote 6 to 1.)

We have some extraneous or unnecessary phraseology on lines 21 to 23, page 216, "or any foreign country while engaged against the German Government in the present war, 10 per centum."

I presume you would also want that to come out.

The CHAIRMAN. If there is no objection, the draftsmen will see that is stricken out.

Senator SMOOT. I move to disagree to line 3, page 217, portable electric fans, 5 per cent.

(The motion was unanimously agreed to.)

Dr. ADAMS. The next change is in old 19, articles of fur, lines 22 to 25. That rate is cut in half, with certain exemptions on fur coats used in the Northwest.

Senator LA FOLLETTE. I move to agree to 10 per cent tax—to change the rate.

Dr. ADAMS. I think the section is a good section, if you want a tax.

Senator WATSON. How does it come you have "partially known as fur, except raw, dressed or dyed skins of sheep, goats, calves, cattle, or horses"? That is not fur.

Dr. ADAMS. But it is so advertised and sold as such, and that is the point. That has been gone over very carefully by the department. Two points are involved: Some changes to exempt heavy coats when worn in the Northwest when cheap; then also the rate was reduced from 10 to 5 per cent.

(The motion of Senator La Follette was carried 6 to 1.)

The CHAIRMAN. If there is no objection, the balance is agreed to.

Dr. ADAMS. Yachts and other boats reduced from 10 to 5 per cent, line 7, page 218.

Senator LA FOLLETTE. I move to disagree.

Dr. ADAMS. I think one thing that influenced the House is that you have a license. I think that weighed with the House committee. The fact that 10 per cent is imposed when you buy and then you pay 10 per cent license for use when you get it has seriously interfered with the sale of these boats, and it is claimed that the industry is in bad shape.

Senator WATSON. I would like to ask what effect the revenue has had?

Mr. MCCOY. The revenue from these yachts is going up. For example, in July, 1920, we collected $104,000, and July, 1921, the last figures we had, we collected $231,000.

Dr. ADAMS. Is that from this section alone?

Mr. MCCOY. Yes, sir; just from this section; the sale of yachts had gone up $100,000.

Senator SMOOT. I move to disagree with the House amendment.

(The motion was carried 6 to 3.)

The CHAIRMAN. The original rate prevails.

Dr. ADAMS. The next change is in toilet soaps and toilet-soap powders, 3 per cent. That is stricken out.

The CHAIRMAN. I move to strike out the House amendment.

Senator MCLEAN. I would like to know the reason for that, Dr. Adams.

Dr. ADAMS. The House eliminated the tax on perfumes and toilet articles. Having done that they struck this out.

The CHAIRMAN. What is the pleasure of the committee? [After a vote.] It is agreed to.

Dr. ADAMS. The following articles on that page run from line 8 to line 24.

Section 904 comes later. That is the so-called luxury tax, in which you have a tax on articles above a certain price. That is a retail tax. That has been widely objected to, and it has been widely evaded. The House desired to preserve a tax on certain of these articles. They based the tax on wholesale articles and imposed the tax upon the producer or importer.

Senator DILLINGHAM. Are these wholesale prices? It says here:

"Carpets and rugs, including fiber, if sold for more than $3.60 a square yard, 5 per centum."

Dr. ADAMS. These figures should be checked. They were adopted without any special investigation.

These are wholesale prices.

Senator WALSH. These rugs that are most commonly used come in sizes 9 by 12. They are selling for $3.60 per yard, made of first-grade yarns. That is wholesale. What would that be retail?

Mr. MCCOY. About $43.

The CHAIRMAN. Would it be practical, Dr. Adams, to recommend another schedule by to-morrow morning, in view of the fact that you say this one was prepared with great haste?

Senator MCCUMBER. I am going to make a motion to strike out all of this matter, commencing with subdivision 20—carpets and rugs and so on—down to the end of the page. That takes out everything. I think we should eliminate all of them.

The CHAIRMAN. What is your view, Dr. Adams?

Dr. ADAMS. I think it should be done more carefully if you are going to do it at all. Personally, I think these taxes unwise.

The CHAIRMAN. If he knocks them out, Mr. McCoy, what difference will there be in the revenue?

Mr. MCCOY. Those that are left in will produce about $5,000,000. Those that were in produced about $25,000,000. They should have brought in about $80,000,000, but it is a tax that is so easily evaded that they did not bring in that amount.

Senator LAFOLLETTE. This would not be so easily evaded, would it?

Mr. MCCOY. No.

Senator LA FOLLETTE. What would this bring in?

Mr. MCCOY. About $5,000,000.

Dr. ADAMS. Why take carpets and rugs? Why pick those out? There are other articles just as eligible.

Senator MCCUMBER. Subdivision 21 provides for trunks, if sold for more than $30, 5 per cent. The great trouble is that you have these things that you can not get for less than that at all.

Senator LA FOLLETTE. That is the wholesale price.

Senator MCCUMBER. I move to strike that out.

The CHAIRMAN. Dr. Adams, would it be desirable for you and Mr. McCoy to recommend to the committee to-morrow a schedule which might bring in $10,000,000 instead of having us roam around on this subject?

Dr. ADAMS. We could make some suggestions.

The CHAIRMAN. Senator McCumber has moved to strike that all out. [After a vote.] The motion is not agreed to.

Senator CURTIS. I would like to have the experts here add to this mahogany tables and some other articles that are really luxuries.

The CHAIRMAN. Very well. Write down those articles and submit a list to the committee.

Mr. MCCOY. This will mean finding new articles to tax.

The CHAIRMAN. Yes. This would mean levying a new tax. These are taxes already in existence.

Senator LA FOLLETTE. There are lots of them already in the law.

The CHAIRMAN. What is the pleasure of the committee as to the provision on page 219 imposing certain taxes on a number of alleged luxuries? [After a vote.] The vote is 2 in favor and 1 against.

Senator DILLINGHAM. The truth is, Mr. Chairman, that the committee is not ready to vote on these things. The suggestion has been made that they are wrong in some respects, and if they are not right there should be time taken to go through them and make some reasonable percentages.

Senator CURTIS. I suggest that the experts go over the matter and pick up some of the luxuries and give us a list of them tomorrow.

Senator MCCUMBER. The idea is now that there are new articles to be inserted—that is, articles not in the old law.

Dr. ADAMS. Yes.

Senator LA FOLLETTE. Let us pass it over for the time being.

The CHAIRMAN. What does the committee want to do with reference to this page?

Senator CURTIS. Mr. McCoy is going to submit some new articles.

The CHAIRMAN. Perhaps Dr. Adams might make some recommendations as to what should be done in connection with the whole business.

Dr. ADAMS. On page 219 we come to an article which Senator McCumber referred to a moment or two ago.

Senator SMOOT. Just a moment. With reference to 901, why did they strike that out?

Dr. ADAMS. We are coming to something over here before you get to that.

"If any manufacturer, producer, or importer of any of the articles enumerated in this section customarily sells such articles both at wholesale and at re-

tail, the tax in the case of any article sold by him at retail shall be computed on the price for which like articles are sold by him at wholesale."

Senator SMOOT. That is what I had particular reference to. I did not notice that. I think Senator McCumber's statement is absolutely correct as to that. For instance, if you strike that out now you will have three different sorts of taxes—the manufacturer's tax, the jobber's tax, and the retailer's tax. The way we have it now it is wherever it is sold, and it does seem to me that the only way to do it is to put it the way the present law has it.

Dr. ADAMS. What is it you want done there?

Senator SMOOT. I say that if you repeal this now there will be a manufacturer's tax, a jobbers' tax, and the retailer's tax. It reads: "If any manufacturer, producer, or importer of any of the articles enumerated in this section customarily sells such articles both at wholesale and at retail, the tax in the case of any article sold by him at retail shall be computed on the price for which like articles are sold by him at wholesale." Here is a manufacturer who sells at wholesale, while another sells at retail. The way you have it here, if you strike this out, the manufacturer who sells at wholesale will not pay the tax on the retail price. There would be that difference between the two manufacturers.

Dr. ADAMS. If a manufacturer manufactures articles and sells only at retail, do you want him taxed on the retail price or the wholesale price or neither?

Senator SMOOT. It ought to be as it is to-day.

Dr. ADAMS. If a manufacturer sells at retail, he pays on the retail price; if he sells at wholesale, he pays on the wholesale price.

Senator SMOOT. Isn't that fair?

Dr. ADAMS. I didn't understand that to be your view. Under the present law, if the manufacturer sells at retail only, he pays on the retail price; but if he sells both at wholesale and retail, he pays only on the wholesale price. Two competitors pay taxes on a different basis.

Senator MCCUMBER. Why shouldn't it be fixed on the wholesale price if sold at wholsale and on the retail price if sold at retail?

Dr. ADAMS. What I wish is to find out what you want.

There is a conflict between administrative complexity and equity. I think the tax ought to be on the wholesale price. However, opinions differ very widely.

Senator SMOOT. Let the retailer out entirely?

Dr. ADAMS. No; but put the tax on the wholesale price. Get the situation in your mind. The manufacturer who sells both at wholesale and retail is taxed on the wholesale price. The man who manufactures and sells at retail only pays on the retail price, a much higher basis. The manufacturer who manufactures and sells both at wholesale and at retail pays on the wholesale price for what he sells at retail. That seems to me unfair. You have got to go further or not go so far. The House having that situation presented to it, decided to put it on the actual price at which it was sold. I think there is no proper choice between that and going to the other extreme and saying that everybody shall pay on the wholesale price, and if they do not sell at wholesale, estimate the wholesale price.

Senator DILLINGHAM. Is there any tax on anybody, except the manufacturer, importer, or producer?

Dr. ADAMS. No. If the manufacturer manufactures and sells at retail only, he must pay on the retail price.

Senator SMOOT. He may sell at wholesale or retail?

Dr. ADAMS. Yes; but he pays on the retail price if he sells at retail only.

Senator SMOOT. Why should not the basis of the tax be the fair market value?

Senator CURTIS. Why not let Dr. Adams draw a substitute?

Senator SMOOT. What are the rules and regulations to-day? You are now operating under the fair-market value, are you not?

Dr. ADAMS. No. The law is explicit that if the manufacturer manufactures and sells only at retail he does not get the advantage of this section. If he happens to sell both at wholesale and retail, he does get the advantage of the wholesale price. I think you ought to go further and let the manufacturer who retails only do what the manufacturer who both retails and wholesales can do.

Senator SMOOT. So many of them sell both at retail and wholesale.

Dr. ADAMS. They are taken care of.

Mr. McCoy. I do not see why they should be taxed on a ficticious value. Here is a man selling at wholesale and retail. Suppose practically all of his sales are at retail. If he sells $100 worth of goods a year at wholesale, all his retail sales will be based on the wholesale price. Then, the provision is that if there is no wholesale price it may be estimated. I think it should be put on the price at which it is actually sold. If he sells at retail, he is making a retailer's profit and can afford to pay the tax. I see no reason for complicating the law by having to estimate the price for which it is sold when it is not really sold at that price.

Dr. ADAMS. In that connection, a number of manufacturers—and to my mind they make out their case—came in and proved, not that retailing is done for the profit or fun of it, but that they must retail in order to sell their product. For instance, a new manufacturer of phonograph records wants to get into the business. He has not the Edison or the Victor record. If he wants to get into the market he may have to start at retail. The same thing is true of some manufacturers of pianos. They can not sell at wholesale. They have to sell at retail. Why should they be taxed at higher prices, or on a higher basis, than the manufacturer who is selling at both wholesale and retail?

Senator McCUMBER. I do not quite get your point.

Dr. ADAMS. Well, here is a manufacturer, John Smith, who is selling at retail at No. 1 Broadway, New York. He is taxed on the retail price. That is the only selling place he has. Here is a manufacturer, William Jones, at No. 3 Broadway, next door, who sells at both wholesale and retail. The tax in his case is imposed only on the wholesale price, and the wholesale price will not be more than 50 per cent of the retail price, perhaps.

Senator McCUMBER. Even then I can not see where the injustice comes in. Suppose a manufacturer manufactures an article and sells it at a wholesale price of $1,000. He sells, we will say as an example, a piano for $1,000. He pays 5 per cent tax on that $1,000. There is $50.

Dr. ADAMS. Yes.

Senator McCUMBER. Another manufacturer manufactures that same piano and he sells it at retail for $1,500. He has made a great deal more. He made $500 more upon his sale than the fellow who sold it for $1,000. Why shouldn't he pay on the $500?

Dr. ADAMS. The retailer does not make any more than the first wholesaler. He is forced to retail to get an outlet. The manufacturers who retail do it because they are forced to retail to get an outlet for the goods.

Senator SIMMONS. When they do that they make more money than when they do not.

Dr. ADAMS. I do not think so.

Senator McCUMBER. Take the case that I have illustrated. The sale is made for $1,500.

Dr. ADAMS. He pays only 5 per cent on $1,000 if he sells both at wholesale and retail.

Senator McCUMBER. Why shouldn't he pay 5 per cent on $1,500 just as much as he should pay 5 per cent on $1,000?

Dr. ADAMS. The law is that he pays on $1,000.

Senator McCUMBER. I know that, but that is not right.

Dr. ADAMS. Then you want to agree to the House provision?

Senator McCUMBER. Yes; if that is what it amounts to.

(Informal discussion followed.)

Senator WATSON. Senator Smoot, do you propose to have a tax based upon the fair market price of the article?

Senator SMOOT. A tax based upon the price of the article.

The CHAIRMAN. What is the motion before the committee?

Senator SMOOT. My motion is that we provide a tax to be imposed upon the manufacturer and based upon the fair market price.

Senator WALSH. I move, as a substitute, that we adopt the House amendment, which I understand makes the man who is a wholesaler and retailer of goods pay on the price that he gets for the goods.

Dr. ADAMS. Everybody to pay on the price actually received?

Senator WALSH. Yes.

Dr. ADAMS. They use the wholesale price now. The law forces every retailer to concoct a few wholesale sales, in order to get the advantage of the wholesale price.

The CHAIRMAN. Is the committee ready to vote? If so, the question presented by Senator Walsh will be submitted; that is, that the House amendment be accepted.

The vote stands 8 to 3. It is therefore agreed to and the provisions will remain as written in the bill.

What is next, Dr. Adams?

Dr. ADAMS. Section 901 is reproduced in the new section 901, beginning at line 24, page 219, with some additions. The provision originally was meant to prevent the abuse of this tax by reducing the price through agreements, arrangements, or understandings. That has been strengthened to provide positively that where a concern sells through a subsidiary the tax shall be based upon the price charged by the subsidiary or affiliated corporation. The other provisions in the old law also remain. It is done to protect the Treasury; it adds another safeguard.

Senator CURTIS. I move its adoption.

The CHAIRMAN. It seems to be unanimously agreed to.

Dr. ADAMS. The next is section 902, sculpture, paintings, statuary, art porcelains, and bronzes.

[After informal discussion.]

Senator LA FOLLETTE. I move to restore the rate, or to disagree to the House amendment.

The CHAIRMAN. It is moved by Senator La Follette that the Senate committee disagree to the House amendment of 5 per cent.

The vote stands 6 to 3 in favor of Senator La Follette's motion. It will be 10 per cent, then.

Dr. ADAMS. There is no change until we come to page 224, section 905.

Senator GERRY. I see that you have a tax on marine glasses. Are they used in shipping to a large extent?

Senator LA FOLLETTE. Where is that?

Senator GERRY. Page 204.

Dr. ADAMS (reading). "Watches, clocks, opera glasses, lorgnettes, marine glasses and binoculars."

Senator GERRY. I am speaking solely of marine glasses. I was wondering why there is a tax on them and whether it is wise. I know that during the war we were short and that everybody was asked to contribute to the department during the war. That was because the lenses were made in Germany. Whether or not there are a great many now, I do not know.

Dr. ADAMS. I do not know, but I do know that there has been no strong movement to abolish the tax. The point that you make was raised during the war, but not since.

The CHAIRMAN. That paragraph is agreed to as it comes from the House.

Dr. ADAMS. Page 226, paragraph 907. That is the tax on medicines and proprietary articles.

The CHAIRMAN. I move that the Senate committee disagree to the House provision.

Dr. ADAMS. The Republican members, you know, took action on this. They resolved to put a tax on the producer or manufacturer of 4 per cent.

The CHAIRMAN. Did we take that action, Senator Smoot?

Senator SMOOT. I have no recollection of having voted on it.

Dr. ADAMS. I have a record that you did.

The CHAIRMAN. Would that bring in about the same revenue?

Dr. ADAMS. It would bring in more revenue. It is to be put on the producer. It is now a stamp tax.

Senator SIMMONS. That is paragraph No. 2?

Dr. ADAMS. One and two.

The CHAIRMAN. What does your department recommend?

Dr. ADAMS. The department did recommend that.

Senator SMOOT. If we want only to raise that amount of tax, a 3 per cent tax on the manufacturer will bring out more money than a 5 per cent tax on the retailer. The retailer does not pay the tax if he can get out of it.

Senator CURTIS. Let us have the amendment suggested by the department.

Senator SIMMONS. Does that include all proprietary medicines?

Dr. ADAMS. Yes.

Senator SIMMONS. I am rather in favor of all these things until you get to medicines. I do not believe in taxing medicines.

(After informal discussion.)

Dr. ADAMS. Do you think that the consumers pay the tax on the proprietary medicines?

Senator MCCUMBER. Do they?

Dr. ADAMS. I doubt it very much.

Senator MCCUMBER. Well, the consumer pays every time you put a stamp on it.

Dr. ADAMS. Yes; but they do not always put it on.

Senator SIMMONS. I move to exempt medicines.

Dr. ADAMS. You understand, of course, that this applies only to such things as liniments, salves, ointments, pastes, and other medicinal preparations as to which the manufacturer or producer claims to have any private formula, secret, or occult art for making or preparing the same. That is to say, ordinary medicinal articles which do not come within that category, are not taxed.

Senator WALSH. Would this reach that growing class of "booze" medicines?

Dr. ADAMS. It already reaches them. It does not apply to the ordinary, standard remedies that are not claimed to be based on secret formulas and are not advertised as having some sort of special virtue.

Senator SMOOT. I think there ought to be some difference between proprietary medicines and perfumes, etc. They ought to be 4 per cent and the others perhaps 2 per cent.

The CHAIRMAN. What do you suggest, Dr. Adams?

Dr. ADAMS. Mr. McCoy, do you think that 2 per cent would yield as much as the present rate?

Mr. MCCOY. We have had a 1 and 2 per cent tax on the manufacturer and a 5 per cent tax on the retailer. That has fallen down. The 1 per cent tax is paid by the manufacturer. He does not pass it on. It is doubtful whether he would pass the 2 per cent tax on.

The CHAIRMAN. Shall we make it 2 per cent?

Mr. MCCOY. Two per cent would bring in more money, probably.

Senator SIMMONS. You are speaking of proprietary medicines? You are not speaking of cosmetics?

Mr. MCCOY. They will buy the cosmetics irrespective of the cost.

With respect to proprietary medicines, anything that has a name in addition to the article itself, is taxed as a proprietary medicine. There are lots of these medicines that are used by physicians. They prescribe them. They are not really patent medicines.

Senator MCCUMBER. How about these medicines that sell for $1 per bottle and 50 cents per bottle?

Mr. MCCOY. Most of those would stand the tax.

The CHAIRMAN. What do you advise, 2 per cent or 1 per cent?

Mr. MCCOY. I should say that 2 per cent would bring more revenue than the present law.

The CHAIRMAN. Gentlemen, shall we make it a manufacturers' tax of 2 per cent on proprietary medicines?

Dr. ADAMS. I understand you want 4 per cent on extracts and toilet waters and 2 per cent on proprietary medicines.

The CHAIRMAN. It is agreed to.

Senator MCCUMBER. While I think of it, Mr. Chairman, there is an omission. I do not want to let it go by. It may not apply here, but it affects your State, Senator Simmons, where you have Pepsi-Cola, Cherry-Cola, Coca-Cola, and various other drinks of that kind. You find the advertisements pasted on every fence post. You are interested in it. Inadvertently, they have left out Coca-Cola, and are getting no tax whatever.

Mr. MCCOY. There is no tax on any extract or essence. The tax is on fountain sirups. Coca-Cola comes in barrels. When it is carbonated it pays the duty of carbonated water. The extract itself does not pay a tax.

Senator MCCUMBER. But other extracts of other things do pay taxes.

Mr. MCCOY. Fountain sirups.

Senator MCCUMBER. Why shouldn't Coca-Cola be included?

Mr. MCCOY. Coca-Cola is about the only one that is manufactured and put up in barrels. It is then shipped all over the country and later put into bottles.

The CHAIRMAN. Why should the tax be taken off?

Mr. MCCOY. I should imagine that there would be a tax on all essences used primarily for soft drinks. They would not tax it when used by the householder.

Dr. ADAMS. If Coca-Cola is not in it is a crime. I was under the impression that the term "sirup" included those things. That depends, however, upon the rulings and upon understanding.

The CHAIRMAN. Dr. Adams, will you fix this paragraph so that it will cover Coca-Cola?

Dr. ADAMS. I will look up the language and see what the scope of it is.

The CHAIRMAN. You will report on it, Doctor?

Dr. ADAMS. Yes.

You have next the provisions on pages 227, 228, and 229. They are meant to accomplish this purpose. Many of these excise taxes have been repealed. These provisions deal with contracts which have been made with the understanding that the tax would be imposed, so that the tax is in the price. This gives the producer, under such circumstances, the right to a rebate equivalent to the tax, or, if a new tax is imposed, makes the purchaser pay that tax. It takes care of contracts made before the enactment of the tax.

Senator CURTIS. Is that the department's recommendation?

Dr. ADAMS. No; we forgot it. Mr. Beaman drafted it.

Senator CURTIS. I move its adoption.

The CHAIRMAN. Is it usual to put anything like that in a tax bill?

Dr. ADAMS. It has always been done in the past.

The CHAIRMAN. It was never done with respect to tobacco.

Dr. ADAMS. Yes; the one difference is that you are reducing some taxes.

The CHAIRMAN. I do not recall it having been done with reference to beer and things of that kind.

Dr. ADAMS. It is done in the general provision.

The CHAIRMAN. Is there any objection to concurring in this highly technical provision?

Dr. ADAMS. The date is August 15, 1921. The contract has to be made prior to that.

The CHAIRMAN. Is there a time limitation on it?

Dr. ADAMS. It does not affect the Government. There is no revenue affected one way or the other.

The CHAIRMAN. If there is no objection, it will be agreed to.

What other knotty problems are there, Dr. Adams?

Dr. ADAMS. The knotty problem you first come to is the provision at the top of page 232, the effect of which is to extend the period in which claims for refund under the capital-stock tax may be made. I would like personally to recommend that you disagree to that for this reason: This was sent to me by the division concerned, and I introduced it in the House. The chief of the division is ill. He thinks, however, that it is a thoroughly bad provision.

The CHAIRMAN. Dr. Adams wants us to disagree to it so that it can go to the Senate, and later he will submit an amendment. If there is no objection, the committee will disagree for the time being.

Dr. ADAMS. The only other thing is a question raised by Senator Swanson. Did you act on that?

The CHAIRMAN. We agreed to that.

Dr. ADAMS. The next page is 240. This is the license tax on boats. "On and after January 1, 1922, the tax imposed by this section shall apply only in the case of yachts or boats over 5 net tons and over 32 feet in length." It is to relieve the small boats. I think, personally, that is right.

The CHAIRMAN. If there is no objection, that will be agreed to.

Is there anything else?

Dr. ADAMS. I have nothing else here.

Mr. WALKER. With reference to the provision on page 244 we would like to have that go over. They are asking that a special provision be put in excepting coco leaves from this tax, so that the tax will apply only on the derivative. The coco leaves are imported and made into different preparations.

The CHAIRMAN. The provision will be referred to Dr. Adams and will go over temporarily.

What is next?

Dr. ADAMS. I am not ready on the stamp-tax amendment.

The CHAIRMAN. The committee will stand adjourned until to-morrow at 10.30 o'clock.

(Thereupon, at 5 o'clock p. m., the committee adjourned until to-morrow, Thursday, September 15, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

THURSDAY, SEPTEMBER 15, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Gerry, Jones, and Walsh.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. The committee will come to order.

Dr. Adams, what is the next proposition?

Dr. ADAMS. We have a number of miscellaneous items. I have the amendments generally to the estate tax title and a number of miscellaneous things.

The CHAIRMAN. How had we better begin?

Dr. ADAMS. I think it would be best to take up the miscellaneous items.

The CHAIRMAN. I was going to suggest that we take up the estate tax first. There may be a lot of little things that we can leave to you.

Dr. ADAMS. Very well. The estate tax amendments are, for the most part, little things, although they are important, in the sense of preventing friction.

Senator CURTIS. Do they affect the revenue at all?

Dr. ADAMS. Practically none of them.

Senator CURTIS. If they are of that nature, I suggest that we permit Dr. Adams to make those changes.

The CHAIRMAN. I am entirely willing to do so. What is the nature of the amendments?

Dr. ADAMS. They are purely to clear up points of doubt in the law.

The first one that I come to you might leave to me. It relates simply to a change in the law, changing 180 days into the term of six months. The reason for that is that some of the estates are very large and do not calculate the 180 days right, which causes penalties.

The CHAIRMAN. Just what is your opinion, Dr. Adams? We have to trust there largely to you. Is there anything in those amendments to which you have reference that would call for the discretion of the committee, or do they come fairly within your jurisdiction?

Dr. ADAMS. There are one or two things that I should like to call your attention to.

The CHAIRMAN. Select those one or two and let the others go.

Dr. ADAMS. Very well, sir. We begin now at page 138.

The CHAIRMAN. Do not impose upon us anything except the two or three things that you think are really important and that you ought to be sustained in by our knowledge.

Dr. ADAMS. Page 141 is the first thing that should be called to your attention. I think that ought not to be done without the committee's consent. This is section 402, dealing with the value of the gross estate. Beginning at page 140, it defines the value of the gross estate.

You will find that in paragraph (b), line 24, you include in the value of the gross estate the value at the time of death.

"The extent of any interest therein of the surviving spouse, existing at the time of the decedent's death, as dower, courtesy, or by virtue of a statute creating an estate in lieu of dower or courtesy."

Later you include property passing under the general power of appointment. That raises a question in regard to community property laws similar to that raised under the income-tax act. If you put estates' interests existing at the time of decedent's death as dower or courtesy, and you put in the power of appointment, the question then arises whether you do not wish to put in the interest of the surviving spouse in the marital community property of which at the time of death the husband had management or control. Ought that not to go in? The department raises that question.

Senator CURTIS. Will that simplify the law, Dr. Adams?

Dr. ADAMS. Yes. It is an important point.

Senator MCCUMBER. It makes quite a difference. I would like to have you give us an illustration.

Dr. ADAMS. In some of the Western States where they have community property laws there is a theoretical basis—and sometimes it becomes actual——

Senator MCCUMBER (interposing). What you mean is property acquired after marriage and which belongs to wife and husband?

Dr. ADAMS. Yes; in equal parts. That is the law. Furthermore, the husband, as a rule, exercises a very wide power of management and control. He can expend it for most any purpose. In California he can actually will it if he does not absolutely denude the wife; that is, if he does not absolutely give it all away.

The extent of the management and control is so great that it puts the community property very closely, for practical purposes, in the status of any property owned by any husband—that is, property acquired after marriage.

Suppose, for example, the husband dies. Should that property—all of it—be included in his estate, or should it be cut in half and should it be assumed that the wife, for purposes of the estate tax, does in fact own the other half? The present estate tax is very sweeping, in taking into the husband's estate all these interests and things of these kinds. If you want to carry out the scheme logically and include all that sort of thing, you would have to put this in. It is, however, a major and a very important question.

Senator MCCUMBER. Suppose that we do not want to tax the surviving spouse for what that spouse actually owns. It does not take, through the death of the husband or wife, any more than it would if the husband and wife held joint interest in common, each a half moiety in real estate, and the husband died. There can only pass—no matter to whom it may pass—a half interest in that estate. If he has only a half interest in the property acquired after marriage, then only a half interest can be devised and only a half interest can go to the survivor. Is the idea that where only a half interest goes under the community property law that the estate shall only pay on that half?

Dr. ADAMS. It is the idea to change that. Take the illustration to which you have alluded. Paragraph (d) provides this: "To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to e'ther or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter," and so on.

Senator DILLINGHAM. This is for the purpose of reaching it by taxation?

Dr. ADAMS. It is for the purpose of putting it in the estate and subjecting it to taxation.

Senator MCCUMBER. I do not think it should be.

Senator DILLINGHAM. In Vermont property that is conveyed to the husband and wife as husband and wife goes to the survivor at death. They are the joint owners during life. This would assess it to the husband?

Dr. ADAMS. I think the present law assesses it to the husband.

The point I am making in general is that the present statute is very sweeping, in that it includes in the estate of the person who dies all these things—the whole property where the husband and wife hold the property jointly or as tenants in the entirety, except in the single and rather unimportant case where that property can be shown to have originally belonged to some other person and never to have belonged to the decedent. Again, there is the property passing under general power of appointment.

My point is this, that it is sweeping; that it is of wide scope. I am in doubt about the logic of the entire thing. I think that if I had written it I would have agreed with you, Senator McCumber. The point, however, is this, that these community laws, which are exceptional, because only eight or nine States have them, throw the whole scheme out of joint and introduce a striking discrimination between those sections of the country and the East.

The CHAIRMAN. What is the use of taking it up?

Senator SMOOT. I think it should be considered.

Senator MCCUMBER. The law now provides that the wife, taking her own property, has got to pay a decedent's estate tax on it. I think that law ought to be changed.

Senator WATSON. So do I. Is that the situation, Doctor?

Dr. ADAMS. I was saying that it is not the situation. There was doubt about it, and this would make it taxable.

Senator LA FOLLETTE. Does it make it any more taxable?

Dr. ADAMS. Yes; distinctly so. It affects the revenue. It makes a larger estate.

Senator MCCUMBER. I think it ought to be changed.

Dr. ADAMS. The notion is to bring into the husband's estate that part of the so-called community property of which he has had management and control during his life.

Senator LA FOLLETTE. That is, property that belonged to the wife independently of the husband?

Dr. ADAMS. Not independently, Senator. It is property which has been acquired by the husband and wife after marriage. In some States that works automatically.

Senator LA FOLLETTE. In which he has an equal interest?

Dr. ADAMS. Yes; in which he has an equal interest.

Senator LA FOLLETTE. This proposes to tax at the husband's death that part of the property which belongs to her?

Dr. ADAMS. You say "belongs." That is the whole question.

Senator MCCUMBER. The laws says "belongs" to her.

Dr. ADAMS. Whom does any property belong to if you may spend it for your personal purposes or even give part of it away?

Senator MCCUMBER. I do not think that makes so much difference. Under the law the wife has an undivided interest—a half interest or a third interest—in this property. That is her's even though the law may not hold the husband to strict account in the management of it. Nevertheless, whatever is left belongs to her. I do not think she ought to pay an estate tax on it.

Senator WATSON. She has a third interest in it.

Dr. ADAMS. That thing is disregarded and that goes into the estate. That is taxed under the existing law. She also has property held jointly or as tenants in entirety.

This is a doubtful question. If I have made my argument for it clear, I am perfectly willing to stop now.

Senator WALSH. To what extent can people have property put in the name of husband or wife to escape taxes?

Dr. ADAMS. If they acquire or hold it jointly it is taxed.

Senator MCCUMBER. You will have to add to your statement in answer to the question that in most of these States if a gift is made in expectation of death to escape the tax it is invalid. Also, in some States—I think in California—if it is made within five years prior to death it does not escape taxes.

Senator WALSH. Is this a recommendation of the Treasury Department for the purpose of eliminating abuse?

Dr. ADAMS. I do not think it is an abuse. There are but few States that have these laws—not a few, but eight or nine of them. They are the far Western States, which provide that any property acquired after marriage becomes, in this sense, community property in which the wife has a half interest. That is legal property, and in practice it does not actually mean "belong," as we use that word ordinarily.

In California, for instance, it has been held that it belongs so little as community property that the husband may give it away or bequeath it, if he does not give it all away; that is, if he does not denude the wife absolutely. I think that in almost every State the husband may spend that property and use it to buy automobiles, for instance, if he wishes.

The question that appeals to me is this and this only: Is not the power and control which the husband has over that property so great that it approaches practically to the husband's own property, and had you not better treat that particular class of property as it is treated in the other States?

Senator MCCUMBER. In that way you avoid the law of the States.

Senator WALSH. We should be governed by the laws of those States.

Senator LA FOLLETTE. What do the inheritance tax laws of those States do with it? How do they treat with it?

Dr. ADAMS. I think they treat it as a separate estate and do not tax it.

Senator GERRY. Isn't there another question besides that to be considered?

(Informal discussion followed.)

Senator WALSH. How do you distinguish these cases, Dr. Adams, from those coming within the laws of the Eastern States?

Dr. ADAMS. In the first place, the laws are quite distinct. Secondly, it happens simply by virtue of the marriage. Anything that they acquire after marriage is ordinarily affected by these laws, except that in some States the actual earnings of the wife are segregated. The earnings of the husband and any profits which he may make in ordinary business are affected by this situation. The aspect of uniformity is one which impresses me. I was wondering whether one rule should exist in one part of the United States and another rule in another.

You must also take into consideration the question of the rates. Senator Gerry's point made a moment ago was a good one. If I had been voting on the estate tax I should have followed his reasoning. It is not such a serious thing when you give $50,000 deduction and the first tax is 1 or 2 per cent.

Senator SIMMONS. Anything is serious, Dr. Adams, that deprives a person of his rights. If I understand this community principle, it is very analogous to joint tenancy.

Dr. ADAMS. I think so.

Senator MCCUMBER. Tenancy in common, rather, I should say.

Senator SIMMONS. Yes; it is very much like that. It is a case where each one owns a half interest in the property and the survivor owns the total interest. Is that the point?

(Informal discussion followed.)

The CHAIRMAN. Gentlemen, we must get through with this bill. I would like to ask Senator McCumber to make a motion.

Senator MCCUMBER. I move that it is the sense of the committee that where the surviving spouse has an interest, a community interest, or an interest in common, the interest shall not be taxable upon the death of the other spouse.

Dr. ADAMS. That is not to disagree to this?

The CHAIRMAN. What is the sense of the committee?

Senator WALSH. Just a moment. Dr. Adams, does the department recommend this in the interest of uniformity?

Dr. ADAMS. Yes.

The CHAIRMAN. It is moved and seconded that the Senate committee disagree to the proposition as explained by Dr. Adams.

Senator SIMMONS. I do not know that I got your point exactly. I assume that it means you do not tax.

Dr. ADAMS. Yes.

The CHAIRMAN. It is agreed to.

Senator GERRY. I might make a motion later to strike out the dower.

The CHAIRMAN. You could make it now.

Senator GERRY. I will make it now. I make a motion to strike out the dower right.

Senator SIMMONS. That is, to exempt the dower?

Senator GERRY. Yes.

(After a vote.)

The CHAIRMAN. It is not agreed to.

Dr. ADAMS. The next change is one that might almost be left to me, but I will mention it.

The CHAIRMAN. I would not mention it, then.

Dr. ADAMS. Very well.

Page 143, line 9. These are deductions from the gross estate. You deduct unpaid mortgages. This gives deductions for unpaid mortgages, in computing the value of the estate. It should be computed only where the property by which the mortgage is secured is in the estate.

We do not include in the gross estate, under an opinion rendered by the Attorney General, property situated in foreign countries. I want to limit this unpaid mortgage proposition in the following language: After the word "mortgage," line 9, insert "upon or any indebtedness in respect to property (except in the case of a resident decendent where such property is not situated in the United States)."

Senator SMOOT. I do not understand that.

Dr. ADAMS. As an example, a man owns property in England. The property is worth, we will say, $100,000. It bears a mortgage of $60,000. Under the

opinion of the Attorney General, you do not put in the gross estate the property in England.

Senator SMOOT. That is, provided it is outside of the United States?

Dr. ADAMS. Yes.

Senator SMOOT. Oh, that is all right.

Senator MCCUMBER. Will you read it again?

Dr. ADAMS. Line 9, after the word "mortgages" insert the following: "Upon or any indebtedness in respect to property, except in the case of a resident decedent, where such property is not situated in the United States."

The CHAIRMAN. All right. What is next?

Dr. ADAMS. That same point occurs through several passages. I am authorized to make those changes, I suppose?

The CHAIRMAN. You are.

Dr. ADAMS. Page 144, line 21. This deals with deductions. You authorize deductions on account of bequests, legacies, devises, or gifts. That word "gift" has been misused, and for reasons which I have already given; the only gifts which should be affected are gifts in contemplation of death. Therefore, the only gifts which should be deducted are gifts in contemplation of death. You have got to subtract from the gross estate. The thing should be in there from which to subtract it.

The amendment suggested is this: On line 21 strike out the words "or gifts" and insert the following: "or transfers, except bona fide sales for a fair consideration, in contemplation of or intended to take effect in possession or enjoyment at or after the decedent's death." That sort of thing should be deducted.

Senator CURTIS. You used the words "fair consideration." In most States the word "reasonable" is used.

Senator GERRY. Let me have that again, please.

Dr. ADAMS. The thought is this: Why should you give a man a deduction from the gross estate of gifts? What kind of gifts do you mean? The only gift that should go in there is a gift that is taxable.

Senator GERRY. I had reference to the wording.

Dr. ADAMS. The wording follows the designation of the kind of gift, as shown in the statute. You should use the same language.

The next is on page 148, line 5. You have two House amendments here. One of them relates to insurance and exempts insurance taken out in American companies by nonresident aliens. A man in Canada, for instance, takes out insurance in an American company. That is now subject to tax. It is proposed to exempt that.

Senator LA FOLLETTE. Why?

Dr. ADAMS. On the ground that there is no real situs here. It is likely to kill American insurance in foreign countries.

Senator DILLINGHAM. It does not amount to very much, does it?

Dr. ADAMS. It is trivial.

Secondly, the House has also granted a deduction on any monies deposited in any bank, banking institution, or trust company in the United States by or for a nonresident decedent who was not engaged in business in the United States at the time of his death. It has, in the House bill, been exempted. In any event, it is proposed to make that same change. After the words "bank, banking institution, or trust company" insert "bankers," so that it may also happen if it is on deposit with J. P. Morgan, Kuhn, Loeb & Co., or a private banker.

The CHAIRMAN. Very well; go to the next point.

Dr. ADAMS. You come now to a question of some importance, which, if you desire it, I will describe in general and then read the amendment—the question of exempting property which passes more than once by death in a period of five years.

A husband and wife frequently die within a close interval. The property is in the husband's estate and is taxed. The wife dies and it is taxed again. There is now an exemption if the two deaths occur within five years. But this is applicable only to the estate taxes of 1917 and 1918, and strong pressure has been brought to bear to make it applicable to preceding estate taxes. You see, you adopted the estate taxes very rapidly. You adopted one in September, 1916, you increased the rates in March, 1917; you again increased them in October, 1917, and adopted a new schedule of rates in 1918. You have four acts. You gave this privilege with respect to property passing under the laws of 1917 or 1918, and it is now proposed to give it under the earlier acts. The department does not propose it. It is a case to be presented for your judgment and consideration. It is a retroactive provision and would authorize refunds.

Senator SMOOT. Isn't it all settled now?

Dr. ADAMS. No. There are a few cases that are not settled. I think they have not been settled because they are hoping to get a retroactive change in the law.

Senator LA FOLLETTE. What would it cost?

Dr. ADAMS. Probably a million dollars. It is not an enormous amount; still there is a real sum involved.

The CHAIRMAN. What is the fair thing to do?

Dr. ADAMS. My impression is that if you allow it to one you should allow it to another.

The CHAIRMAN. I move that it be allowed.

Senator SMOOT. The reason we allowed it in the later two bills was that it was a higher rate. I do not see why we should do it now.

Senator MCCUMBER. You now provide for five years.

Dr. ADAMS. It is five years.

Senator MCCUMBER. I mean in this bill.

Dr. ADAMS. That is the law. The present bill would make it applicable to all.

The rates in the later acts are as a rule higher. But the experts in charge tell me that the first estate is apt to be larger, so that they feel that if you use the device you recommend you will lose money.

Senator SIMMONS. Does this apply only to refunds?

Dr. ADAMS. It will apply to any cases that arise in the future, but there are also a few other cases. We can not make a change where the taxpayer has not settled without giving a refund to those that have. You did not do it originally because the rates in the earlier acts were lower.

Senator SMOOT. We decided not to do it after careful deliberation.

Senator MCCUMBER. The refund would be on a lower basis, so that the balance would be about the same.

(Informal discussion followed.)

The CHAIRMAN. What is the pleasure of the committee? [After a vote.] It is agreed to.

Senator Gerry, would it be worth while for you to make an effort to get the principle of direct taxes before the committee again?

Senator GERRY. I have thought that matter over very carefully, Mr. Chairman, and believing that it would lead to endless discussion have decided not to do it. Possibly I shall reserve the right to introduce it in the Senate.

The CHAIRMAN. Dr. Adams, you are familiar with Senator Gerry's proposition?

Dr. ADAMS. I am familiar with it, but I could not do anything with it before next Wednesday.

The CHAIRMAN. Does the department recommend it?

Dr. ADAMS. It does not recommend it at the present time in view of the present financial condition. It would be a better basis for taxes and a fairer basis.

The CHAIRMAN. How much would it curtail the revenue?

Dr. ADAMS. A great deal. But it would bring you to the question of adjusting the rates so as to bring in the same amount of revenue.

The CHAIRMAN. I understand, Dr. Adams, the department is not prepared to recommend it in this bill?

Dr. ADAMS. No, sir.

The CHAIRMAN. What is next?

Dr. ADAMS. On page 150 I have a number of small changes.

The CHAIRMAN. They are all agreed to, unless some member of the committee wants them explained. If so, Dr. Adams will go into details.

Dr. ADAMS. Changing 180 days to six months is one.

Senator MCCUMBER. Those are not substantive matters?

Dr. ADAMS. I think they are trivial, except one. I will call your attention to that one. It is on page 150. Strike out the sentence beginning in line 14. This ought to be called to your attention, although it really does not make any substantial change. Strike out the sentence beginning on line 14 with the word "if." That sentence now says:

"If the tax is not paid within one year and 180 days after the decedent's death, interest at the rate of 6 per cent per annum from the expiration of one year after the decedent's death shall be added as part of the tax."

The tax is due within one year.

The CHAIRMAN. What is the amendment?

Dr. ADAMS. In line 14 strike out the sentence beginning with the word "if."

The CHAIRMAN. You want to strike out the limitation, do you?

Dr. ADAMS. I want to put this in.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. The next one is of the same kind. Shall I read it? It is page 150, line 19. Strike out the first paragraph of section 407. That now provides that the executor shall pay the tax to the collector or deputy collector.

"If the amount of the tax can not be determined, the payment of a sum of money sufficient, in the opinion of the collector, to discharge the tax shall be deemed payment in full of the tax, except as in this section otherwise provided."

It means that that shall be deemed enough until the department gets around to a point where it can appraise the property.

It is now proposed, in lieu of that language, inasmuch as the collectors and deputy collectors do not know anything about this thing, to insert the following language, in order to prevent confusion:

(Amendment not printed.)

The last part of it is the present law. That only takes out this thing which is meaningless at the present time—that is, giving the opinion of the collector. The collectors have no opinions on these questions.

The CHAIRMAN. If there is no objection, it will be agreed to.

Dr. ADAMS. The next is the 180-day business, and that is purely mechanical.

The CHAIRMAN. It is agreed to.

Dr. ADAMS. I have a proposal to insert a new section, which would be 411. That would be on page 155, after line 12. The substance of it is to authorize a refund in the future for a period of three years instead of two years. At the present time the taxpayer has a period of only two years in which to ask for a refund. Owing to the great delay in the settlement of these cases, it is not fair to the taxpayer. There ought to be a three-year period.

Senator MCCUMBER. Why should it not be extended to five years? It is five years in the others.

Dr. ADAMS. Yes.

Senator MCCUMBER. Section 252, page 107, allows the taxpayer to file a claim for refund of income and excess-profits taxes within five years from the date the return was due. If you will turn to page 107, you will find that to be the case.

Then, in section 1000, page 232, relative to taxes on capital stock, the provision allows only three years to the taxpayer. There is no more reason for one than for the other.

Then, section 1316, page 285, makes no provision for the time in which the claim shall be filed, but the Commissioner of Internal Revenue holds that it is governed by section 3228, which grants only two years from the date the taxes are paid.

My thought is that no distinction should be drawn between these various kinds of internal revenue taxes as to the time when claims shall be filed. I suggest that that be made five years.

Dr. ADAMS. You reduced the period for income taxes, in which the department must clean them up, from five years to three years.

(Informal discussion followed.)

Senator MCCUMBER. Here is another case, on page 101, section 252. The Government is allowed five years within which to bring action against a delinquent taxpayer. Why not give the taxpayer five years to file his claim for a refund, just the same as you give the Government five years in which to find that he has paid an insufficient amount?

Dr. ADAMS. What section was that, Senator?

Senator MCCUMBER. Section 252.

Dr. ADAMS. Section 252 specifically gives the taxpayer five years in which claims for refund may be filed, and so far from being unfair to the taxpayer, the Government, under that very law, held itself down to three years in the revenue acts prior to the revenue act of 1918. In other words, under section 252 the time to claim a refund was extended to five years under all the revenue acts, so far as the taxpayer is concerned, whereas a similar extension on the part of the Government was confined to the act of 1918.

Senator MCCUMBER. I think you have it reversed.

Dr. ADAMS. No; I am giving it to you right.

Senator McCUMBER. The Government is allowed five years within which to make a claim for additional taxes.

Dr. ADAMS. I try to be fair to the taxpayer, and I resent suggestions that apparently make it out that the Government is trying to be unfair. I shall read section 252, with your permission.

Senator McCUMBER. Yes.

Dr. ADAMS (reading):

"That if, upon examination of any return of income made pursuant to this act, the act of August 5, 1909, entitled 'An act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes,'" and so on, "it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer."

That section 252 gave a period of five years to claim a refund under the excess-profits act and under all kinds of acts starting with the act of 1909. That was done, too, at a time when the Government's right to change the assessment was also changed to five years, but when that was done the Government's right was only extended to the revenue act of 1918. You can not claim that the Government was not generous. The Government gave the right to the taxpayer under all prior acts, but it held itself down to one act.

Senator DILLINGHAM. What is that claim that has been made by some, that that has been a mistake—that some have supposed they had five years and found that they had but two years?

Senator SMOOT. I think Senator McCumber had reference to the section on page 101.

Senator McCUMBER. I mean the section on page 101 of this bill. It is 250, not 252. It is subdivision (d) on page 101. It reads:

"The amount of tax due under any return made under this act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the commissioner within three years after the return was filed, and the amount of tax due under any return made under this act for prior fiscal years or under prior income, excess-profits, or war-profits tax acts shall be determined and assessed within five years after the return was filed, unless both the commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceedings for the collection of any tax due under this act or under prior income, excess-profits, or war-profits tax acts shall be begun after the expiration of five years after the date when such return was filed."

That gives the Government five years. I gave you the wrong section a moment ago. That gives the Government five years in which to make a claim for any additional taxes.

Dr. ADAMS. To bring suit; not to assess the tax.

Senator McCUMBER. The Government has five years. In many cases the taxpayer has paid in excess in order to prevent suit, and he immediately proceeds to protest and file a claim. You say that that must be determined within three years. If the Government has a period of five years in which to call for excess tax, then why not give the taxpayer just the same number of years to ask for a refund of the excess that he has paid.

Dr. ADAMS. The taxpayer has it virtually under this present law. I have no objection to it. You may say that the taxpayer will have a right to bring a suit in the courts. That is not a question of refund. His right in the courts is an entirely different matter. It is four years and six months now.

Senator McCUMBER. I do not think it is generally satisfactory.

Dr. ADAMS. I do not want to argue against the proper thing. The point is that you have other acts in mind. There is no substantive unfairness to the taxpayer in any of the income tax acts. The inequality, in fact, will be against the Government. You have other acts in mind. These provisions that you are discussing affect only the income and excess-profits tax acts. Under some of the other statutes the right of the taxpayer is confined or restricted to two years. You are correct about that. That is the case with estate taxes and stock taxes. You are right in that respect. But section 252 is not affected. This is confined to income and excess-profits taxes.

Senator McCUMBER. What objection would there be to this amendment?

Dr. ADAMS. To five years?

Senator McCUMBER. Turn now to page 232. I can make it clear in a minute; 232 is the one that I have marked here. Take lines 15 and 17 on that page. It reads:

"That no such credit or refund shall be allowed or made after three years from the date when the return was made unless before the expiration of such three years a claim therefor is filed by the taxpayer."

Dr. ADAMS. All we are asking is that he file his claim within three years.

Senator McCUMBER. If the Government has received more taxes than it ought to receive, then it ought to give the taxpayer just the same right to ask for a refund within the given time. That is my point.

Dr. ADAMS. But the five-year period has no application at all. Section 252 does not refer to this. What you have been reading has reference to income and excess-profits taxes.

Senator McCUMBER. Maybe I have not got the section right. Of course I have not time to read them all so carefully.

Dr. ADAMS. At any rate, this was disagreed to and goes out, but even outside of that, should the taxpayer be permitted to file his claim for three years? Is that a good thing?

Senator McCUMBER. There are a great number of instances where the question will finally get into the courts and it will be finally decided, and it will be decided in favor of the taxpayer. It may be after the expiration of the three years before that question in litigation is decided, and inasmuch as the Government is given five years to demand any additional sum that it finds to be due from the taxpayer, why should not the taxpayer have the same five years to ask a refund of the Government for anything that he has paid in excess, and especially in those cases in which he may not know what his rights are at the end of three years. That is a simple proposition. I can not imagine that much danger would flow from it.

Dr. ADAMS. There is the danger of uncertainty in the revenues for a period of five years.

Senator McCUMBER. It is just the question of how much will be in litigation; a questin upon which there is a difference of opinion. It may not involve much, or it may involve a great deal.

Dr. ADAMS. Let us come back to the question we have just discussed. The proposition was to extend the period in which the taxpayer, under the estate tax, might claim a refund. Now, in those various estate taxes with respect to which the House has passed an amendment—an important amendment, too—you have a limited time in which the Government may change the tax to a period of less than two years. It is not a simple question to equalize it. As to the estate taxes, a provision has been inserted by the House. It was talked over here before. When we went over it everybody agreed that it was a good thing as a whole.

Senator REED. Your proposition is, as I understand it, that the man who wants to have a rebate must file his claim within three years after he pays his taxes to the Government; that is, a rebate for the inheritance tax must have been filed within three years. Senator McCumber raises the question that a man may have a suit pending in a court for all that time and that the case may not be determined until after the three-year period.

Senator McCUMBER. Or some outsider may have been waiting until the decision of the court was rendered in that particular case because he was similarly situated.

Senator REED. That latter suggestion, Senator McCumber, would go outside of the suggestion I was going to make, which was simply to insert the words, "That the filing of a suit shall be considered as the filing of a claim," or to insert, after the language which you employ and which I have not before me, the words, "Shall have begun suit within three years."

Dr. ADAMS. It is not a question of changing the statute of limitations or changing the right of access to the courts; it is the period during which he shall have the right to appeal to the administration.

Senator REED. Does he not have to appeal to the administration as a preliminary step? That is always the case.

Dr. ADAMS. Yes.

Senator REED. Is it not the rule in nearly all of our proceedings that where there is a remedy provided in the administrative department of the Government that you must exhaust that remedy before having resort to the courts?

I suggest this, simply to save any doubt about it, that you rewrite it so that it would cover the suggestion of Senator McCumber. I have always found this to be the case, that when an intelligent man, particularly if he is a lawyer, suggests that there is danger in the law it is a great deal easier to change the law than it is to fight the matter out in the courts.

Dr. ADAMS. I shall be very glad to do anything that the committee wants me to do.

Senator REED. Can you give me the particular language? Is it in the printed copy or is it your own?

Dr. ADAMS. I have a copy here which I will pass to you.

Senator MCCUMBER. My request is not confined to these estate taxes, but to all cases. The right to demand a refund should be five years in every case in which the Government is given the right for five years to demand an excess over what it has received.

Dr. ADAMS. That seems to me a very fair statement.

Senator MCCUMBER. That is all I am after.

Dr. ADAMS. Then you have no objection to this change, I take, under the estate tax?

Senator MCCUMBER. Possibly not; I do not know. I think everything should be five years.

The CHAIRMAN. Would it be well to refer this matter to Dr. Adams and the experts with a view to a recommendation from them this afternoon?

Senator MCLEAN. This would affect income tax, premium tax, and stock taxes?

Dr. ADAMS. I can not report on that this afternoon.

Senator MCLEAN. If we provide for an extension of time, that will apply to all kinds of taxes where there has been a failure of any kind?

Dr. ADAMS. You are suggesting an equal rule. You can not get an exact rule. You must make it work both ways.

Senator MCLEAN. We want an extension of time?

Senator CURTIS. Why not draw up a short proviso that where the Government has five years the taxpayer shall have it?

Dr. ADAMS. Let us look at some of the difficulties. The Government's time is limited in some cases to one and one-half years. Do you want the taxpayer limited to one and one-half years? He would have a year and a half in which to pay. That is what it comes to.

(Informal discussion followed.)

Dr. ADAMS. You have all kinds of regulations. For instance, take the special taxes. The Government has a period of only 15 months in which it may change assessments. It must make its determination within 15 months.

I will go through this, if it is the sense of the committee, and try to equalize the situation. It is not an easy situation to equalize, for the reason which I am bringing out. For instance, you have the special ruling on estate taxes. There is the amendment that the House adopted, page 151, which provides that under certain circumstances the Government must make a determination within one year after application by the executor. In other words, the Government is limited very close under these special taxes. Under the special taxes the time is limited to 15 months.

Senator CURTIS. I move that we adopt the Treasury Department's recommendation.

Senator MCCUMBER. What is the Treasury's recommendation? Is that on the estate tax?

Dr. ADAMS. On the amendment.

The CHAIRMAN (after informal discussion). All those in favor of the amendment recommended by the Treasury Department through Dr. Adams, so signify by raising their right hand. [After a vote.] It is agreed to.

Dr. ADAMS. The next thing is one of the disagreeable little matters that I have to bring up. I hate to bother you with it, but it is important. I have an amendment designed to take care of a case that has come up, and doubtless there will be a case from time to time in the future.

The act making appropriation for the Diplomatic and Consular Service, approved June 4, 1920, provides that in probate and administration proceedings there shall be collected by the clerk of the court, before entering the order of final distribution, to be paid into the Treasury of the United States, the same inheritance taxes from time to time collected under the laws enacted by the Congress.

An individual owned property in China, and our authorities over here imposed an estate tax on the property in this country, and the clerk of the court pro-

ceeded to take the full language of the act and levied another full estate tax covering the same property. Up to the present time we have not, by persuasion, been able to bring about a change in that situation.

I have written out a provision which is to this general effect:

"Where no part of the gross estate of such decedent is situated in the United States at the time of his death, the total amount of tax due under this title shall be paid to or collected by the clerk of such court, but where any part of the gross estate of such decedent is situated in the United States at the time of his death the tax due under this title shall be paid to or collected by the collector of the district in which is situated the part of the gross estate in the United States; or if such part is situated in more than one district, then the collector of such district as may be designated by the commissioner."

There are other provisions that the tax shall be imposed only once.

Senator CURTIS. I move that it be adopted.

The CHAIRMAN (after a vote). The motion of Senator Curtis is unanimously agreed to.

Senator SMOOT. I want to refer back to page 35 of the bill. With reference to the deductions allowed I am quite sure that there were some votes cast where it was not understood just what the motion was.

We disagreed to the amendment this morning as to line 5, ending on line 7, and reading as follows:

"Traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business."

The CHAIRMAN. I think the committee made a mistake or the clerks made a mistake in reporting the action of the committee.

All those in favor of reconsidering the alleged decision of the committee in that respect will say "aye."

(The motion was agreed to.)

The CHAIRMAN. All those in favor of agreeing to the House amendment will say "aye."

(The motion was agreed to.)

Senator REED. Mr. Chairman, may I ask the attention of the committee for a moment? While I have been necessarily away the committee passed over or took some action in regard to the tax on cereal beverages. The cereal beverage tax falls upon people who are conforming strictly to the law and are using expensive articles in making their product. They will be handicapped, if not put out of business, if their product is not placed on an equality with the other nonintoxicating beverages.

A man came to me this morning who was an expert on these matters and who can explain just what this will do to the producers of cereal beverages.

Senator LA FOLLETTE (after informal discussion). I will make a motion to reconsider the action taken by the committee yesterday with reference to soft drinks, and then I shall request the committee to hear the statement of Mr. McCoy. He made a very excellent statement on this subject yesterday.

The CHAIRMAN. Mr. La Follette has made a motion to reconsider the vote with reference to the 4 cents per gallon tax on cereal beverages.

Mr. McCoy, you made a statement the other day. You may elaborate it a little at this time.

Mr. MCCOY. Page 196, line 20, deals with section 628 of the present law. Under the present law the tax on cereal beverages is 15 per cent of the price for which they are sold by the manufacturer.

On unfermented grape juice, ginger ale, sarsaparilla, pop, and so forth, it is 10 per cent of the price for which sold.

On natural mineral or table waters sold by the producer or bottler for a price in excess of 10 cents a gallon the tax is 2 cents a gallon.

Those rates at the present time amount to about 15 cents a gallon on fruit juices, 6½ cents a gallon on soft drinks, and 16 cents on soda-fountain drinks. The tax there is 1 cent on each 10 or fraction thereof. That is the ad valorem reduced to the specific rate.

Senator WALSH. On cereal drinks what is it?

Mr. MCCOY. About 4 cents a gallon.

Under the proposed bill the tax on cereal beverages is 4 cents a gallon, which is a little higher than under the present law.

In addition to that there is a further tax on cereal beverages on account of the carbonic-acid gas with which they carbonate them. That is taxed in the new law at 5 cents a pound. Under the proposed law the duty on fruit juices

is reduced from 15 cents to 2 cents a gallon. On soft drinks it is reduced from 6½ cents to 2 cents, plus the carbonic-acid tax, which would bring it up to 2 and a fraction cents per gallon. On the still drinks it is brought down from about 6½ cents to 3 cents a gallon. There is a tax put on the fountain sirups which contain sugar and a flavoring extract. Sometimes they are without a flavoring extract, but the sirups as a rule contain sugar and an extract.

Seemingly the House bill has eliminated from taxation table waters or carbonated waters; that is, Apollinaris, White Rock, etc. Although they sell just as high as do the cereal beverages, they cost very little to manufacture.

Senator WALSH. We restored that yesterday.

Mr. McCOY. I am saying that the House bill eliminated them; and also it eliminated extracts, essences, and concentrates. The Coca-Cola Co. manufacture the extract and sell it to the retailers of the drink. Of course, if they carbonate it, it is taxed as a carbonated beverage.

Senator LA FOLLETTE. Not to interrupt you, unless you have finished, you had something to say yesterday about the expense of manufacturing cereal beverages.

Mr. McCOY. It is more expensive to manufacture than any of these other drinks. A cereal beverage, you might say, is a grain drink as compared with a fruit juice. You can not get the juice from the grain without fermenting it and putting it through various processes. You have to make the malt and you have to have hops. It goes through the same process, in 90 per cent of the cereal beverages, that it went through in the making of beer before prohibition. At the last moment they extract the alcohol and put in a little malt and aerate it. It makes it more expensive than it would to make beer.

Senator MCCUMBER. On an ad valorem basis, how does the present tax upon the cereal beverages correspond with the equivalent upon the other soft drinks?

Mr. McCOY. The ad valorem duty on other soft drinks is 10 per cent, and on the cereal beverages it is 15 per cent.

Dr. ADAMS. You mean under the House bill?

Senator MCCUMBER. I am speaking of the House bill.

Mr. McCOY. As 4 cents compared with 6 cents.

Senator MCCUMBER. I am talking about ad valorem. I want these specific duties converted into ad valorem so that we can see what percentage of the real value the tax has upon each of these kinds of beverages. You have the cereal beverages and the other soft drinks, such as sarsaparilla.

Mr. McCOY. About 5 per cent on the soft drinks and about 18 per cent on the cereal beverage.

Senator REED (after informal discussion). In view of Mr. McCoy's statement, has Senator La Follette's motion been acted upon?

The CHAIRMAN. No; but it is open to reconsider.

Senator LA FOLLETTE. I ask that it be reconsidered by unanimous consent.

The CHAIRMAN. Yes. It is open to discussion.

Senator REED. I move that we make the tax 3 cents on the articles mentioned in paragraphs (a), (b), and (c).

Senator LA FOLLETTE. I would like to ask Mr. McCoy if he can state what quantity of cereal is consumed in the manufacture of this product. How much of a market does it make for the farm production?

Mr. McCOY. There is just as much cereal used in making beer nowadays as in preprohibition times, but it does not all go into this cereal beverage. The industry, if it grows, will consume practically the same amount as the beer did. The taxable cereal beverage at the present time does not now consume more than a quarter.

Senator DILLINGHAM. People have not got in the habit of using it as they did the beer.

Senator LA FOLLETTE. Will it furnish the same market for barley and hops and other agricultural products as the manufacture of beer?

Mr. McCOY. Yes, sir.

Senator WATSON. Does the proposed amendment place all beverages in (a), (b), and (c) on one level, or an absolute equality? I want to ask Dr. Adams what he thinks about it. Personally, I am entirely willing to vote for it, but it may not be the equitable thing to do.

Mr. McCOY. If they were all on the same gallon rate and if we were going to put a tax on the carbonic acid gas it would make (b) a little heavier tax than (c). Carbonic acid gas does not go into fruit juices, but it goes into the cereal beverages and ginger ale, and so on.

Senator WATSON (after informal discussion). What about the revenue involved, Mr. McCoy? If you place the tax on all of them at 2 cents, how would the revenue be affected?

Mr. McCOY. You would gain on the cereal beverage. The tax now is keeping the production of it down, because I am informed that the tax absorbs about all the profits they have been making. You would gain more on the cereal beverages, but you would lose some on the other beverages. You would gain by a more efficient enforcement of the law.

There is another reason why you would probably gain. The bottling industry is very low just at the present time. The income that the department received this July as compared with that of last July has fallen off very much. So, probably, by reducing the tax a little further you would get more revenue.

They would either go out of business or pay revenue.

Senator WATSON. What is your opinion, Dr. Adams?

Dr. ADAMS. I think that both the soft-drink industry and the cereal-beverage industry are unquestionably losing money. There may be isolated exceptions. It is time to deal leniently with both, in my opinion. I think with respect to both of them that they had better be nurtured, and that you better "go easy." If you could find another tax somewhere I would even be in favor of dropping the taxes on them.

The CHAIRMAN. What is the total amount of the beverage tax?

Mr. McCOY. About sixty millions. This year it will probably fall somewhat below. That is the last year's business.

The CHAIRMAN. We can not afford to give that up.

Mr. McCOY. That sixty millions includes the ice cream that you have stricken from this bill.

The CHAIRMAN. Suppose we struck out the tax imposed in (a), (b), and (c); could you say, roughly, offhand, what the loss in revenue would amount to?

Dr. ADAMS. Mr. McCoy is counting on $32,000,000.

Senator REED. I propose to reduce it to 2 cents on all of them. Some one said it would be a good thing, if another source of revenue could be found, to abolish them all.

Dr. ADAMS. There are many aspects of it. The pop that sells for 5 cents a bottle will be bearing as heavy a tax as near-beer which will sell at 25 cents a bottle. That aspect must be considered. I have no doubt that both industries are equally hard hit and that both industries are equally desirable.

Senator REED. Doctor, the bottle of beer that sells for 25 cents has fully twice as much in it as the bottle of pop; and you do not buy pop at 5 cents a bottle any more—at least, I do not get it for that.

Senator LA FOLLETTE. It has a nutrition value; it is a food.

Senator REED. Which is?

Senator LA FOLLETTE. The cereal beverage.

Dr. ADAMS. It is a question of whether you want to be governed by specific or ad valorem rates. I am told by the bottling industry that in most sections of this country they must return to the 5-cent price or not sell at all.

Senator REED (after informal discussion). To get this so that it will not be complicated with any other issue, and with the idea that we may take up (c) immediately afterwards, I move that the tax on the articles named in paragraph (a) be reduced to 2 cents a gallon.

Senator SMOOT. I will amend that motion by striking out "4" and inserting "3."

Senator MCCUMBER. I would like to know what the difference is in cash to the Government.

The CHAIRMAN. I do not think you can tell that, because it might stimulate vastly the consumption.

Mr. McCOY. I do not think there would be much difference between the tax of 2 and of 3 cents.

The CHAIRMAN. The question is on Senator Smoot's amendment to Senator Reed's motion.

(Amendment disagreed to.)

Senator MCCUMBER. I want to make an amendment, simply because I want to vote for Senator Reed's motion and I do not want to reduce it on one and then leave it on the other. I therefore move to include in the Senator's motion subdivision (c).

(After informal discussion.)

Senator MCCUMBER. I withdraw my amendment.

The CHAIRMAN. The question now recurs on the amendment to the House bill making the tax 2 cents per gallon instead of 4 cents per gallon.

(Motion agreed to.)

Dr. ADAMS. Do you want to take up these things in order? There is one point which I promised Senator Dillingham I would mention.

Under (b) you will notice that the tax is "upon all carbonated beverages commonly known as soft drinks, except those described in subdivision (a), manufactured, compounded, or mixed by the use of concentrates, essence, or extract instead of a finished or fountain sirup, sold by the manufacturer, producer, or importer, a tax of 2 cents per gallon."

They would have a carbonated tax to pay, just like the other people, and they will have some tax on the sirups and things they mix with in some instances.

I do not want to urge you to do anything, but I promised to call your attention to it.

Senator DILLINGHAM. The manufacturers up in my section tell me that the difficulty is with the retailer; that the retailer insists that he shall get 7 cents a bottle for it instead of 5. The manufacturers want to hold them right down to the 5 cents a bottle. They say that it destroys the sale, and they claim that they are being taxed in this way in a triple sense. They say this was construed in the department through a mistake in computation by a young man who is now sick, and that he has furnished a memorandum, as I understand it, to Dr. Adams by which it could be slightly amended and they be given the relief they desire.

Dr. ADAMS. The gentleman referred to is dangerously sick. His doctors will not allow him to come here. I have been hoping to get him here, because he is an able man, and I would rather have him here than some of his subordinates.

I will read the memorandum which he left with me.

Senator DILLINGHAM. Please do that, Doctor.

Dr. ADAMS. I confess I do not know the details of this. I have been trying to get this young man here. He has been expecting to be able to get down here. I shall bring one of his subordinates if I can not get him here, or perhaps Mr. McCoy can explain it just as well.

Mr. MCCOY. There is a fallacy in that reasoning. The House bill places a tax of 2 cents per gallon on all carbonated beverages, "except those described in subdivision (a), manufactured, compounded, or mixed by the use of concentrate, essence, or extract, instead of a finished or fountain sirup." If it is manufactured for a fountain sirup, there is no tax at all. So, therefore, why should there be a distinction? That made from the sirup simply takes the sirup tax and does not pay any additional tax.

Senator DILLINGHAM. But that made from the concentrated essence pays 2 cents a gallon?

Mr. MCCOY. Yes, sir. If it is made from the other, it does not pay any additional tax except the tax that is on the sirup.

Senator DILLINGHAM. I think these people use the concentrated extract.

I suggest that you abolish the tax on the sirup and tax all the carbonated beverages 2 cents. Strike out the tax of 10 cents a gallon on fountain sirups in (d) and change the language in (a) so that when manufactured or compounded they would pay no tax on any of the material.

Senator SUTHERLAND. That would be easier to collect than the other?

Mr. MCCOY. Much easier to collect. Anybody can make these sirups.

Senator CURTIS (after informal discussion). I want to make a motion to strike out (b) and (d) entirely.

Mr. MCCOY (after informal discussion). I would suggest, if you want uniformity, that you make the rates 2 cents a gallon in (a), (b), and (c); leave (d) as it is. You have stricken out the exception of natural or artificial mineral and table waters in (c). You want to include in (b) carbonated waters. I think you concluded yesterday to put the carbonated waters in (b) and still waters in (c).

The CHAIRMAN. You will get uniformity in that way and keep up your general scheme.

Senator CURTIS. What is the matter with putting my motion first?

The CHAIRMAN. Your motion is to strike them out?

Senator CURTIS. Yes.

(The motion of Senator Curtis was disagreed to.)

The CHAIRMAN. I submit the motion making a uniform tax of 2 cents and putting carbonated waters into paragraph (b).

(Motion agreed to.)

Senator SUTHERLAND. What was done about the suggestion yesterday to catch the Coca-Cola and similar extracts?

Mr. McCOY. That is really caught before it gets into a beverage now, but the tax does not fall on the Coca-Cola people; it falls on the people who buy from the Coca-Cola people.

Senator SUTHERLAND. Was it not referred to the experts?

Mr. McCOY. Yes, sir.

Senator MCCUMBER. It was thought by Dr. Adams that it was probably in there; but if it was not, it would be put in.

Dr. ADAMS. I will report to you either this afternoon or to-morrow morning on that. I would have reported to-day if it had not been for the illness of the head of that department.

I have an amendment on page 33, line 17, dealing with the shipping exemption. This amendment proposes to exempt, under certain reciprocal arrangements, the earnings of foreign shipping companies. The meaning of it I think will appear as I read it:

After the word "corporation," in line 17, insert the words "more than 95 per cent of," so as to make it read:

"The income of a nonresident alien or foreign corporation, more than 95 per cent of which consists exclusively 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 and to corporations organized in the United States."

I want to add to the conclusion of that the words "to the extent of such earnings."

The CHAIRMAN. Is there any objection to the amendment submitted by Dr. Adams? If not, it is agreed to.

(After informal discussion.)

Dr. Adams, you request that in order to facilitate the work the committee sit until 1.30 and then adjourn until to-morrow morning?

Dr. ADAMS. Yes, sir. Page, 34, line 12. You can grasp this point without my giving you the details for a moment. We make no recommendation in regard to it; but the State Department has raised the question, and the department is now troubled about it as to whether the income of ambassadors in this county should or should not be taxed. The proposal from the department for your consideration is as follows: On page 34, after line 10, insert the following new paragraph, which would be an exemption:

"The income of alien ambassadors, diplomatic agents, consuls, or consular agents, when the foreign country which they represent grants an equivalent exemption to ambassadors, diplomatic agents, consuls, or consular agents of the United States."

I think, personally, it ought to be done.

Senator DILLINGHAM. I move its adoption.

(After informal discussion.)

Senator REED. Let me suggest this language:

"Alien representatives of foreign Governments shall be exempt from all taxation upon all of their income and investment derived from sources outside of the United States."

I would like to add the language to the last of this section, "when equivalent exemptions are granted to representatives of the United States."

Senator SIMMONS. Have foreign Governments been incorporating in their laws any such exemption?

Dr. ADAMS. Yes, sir; they have. It is a most difficult question and the most delicate question in the world for us to go after those people and tax them. I do not care anything about the consular agents. I really had doubts about that, myself, but I wanted to bring it before you. It avoids the difficulty if we can go and say, "We deal with your people exactly as you deal with ours."

Senator SIMMONS. Has the State Department suggested it?

Dr. ADAMS. It has not suggested this, one way or the other.

Senator REED (after informal discussion). I suggest this, Mr. Chairman, to save time, that the amendment that I have dictated here be sent down to the Secretary of State to see if it is satisfactory to the State Department.

Dr. ADAMS. I think time is very pressing. It is not important enough.

The CHAIRMAN. We can put it in on the floor of the Senate.

Senator REED. I move the adoption of my motion.

(Motion agreed to.)

Senator REED. I move that it be sent to the State Department and that inquiry be made of the State Department as to whether it is satisfactory to them.

The CHAIRMAN. It will be sent to the State Department by the committee to get their views. Mr. Walker, will you see that that is done this afternoon, if possible?

Mr. WALKER. Yes, sir.

Dr. ADAMS. Page 37, line 9. There you have a provision covering the buying and selling of securities. Senator McLean and others have asked to have an amendment drafted so as to make it plain that that does not apply to dealers. That could be taken care of on page 37, line 9, by striking out the words "paragraphs (4) and" and restrict it only to paragraph (5).

Senator LA FOLLETTE. Why should it not apply to dealers?

Dr. ADAMS. They do not pay anything now, Senator. Any good that they get out of it they get by having the right to inventory their securities, anyhow. The dealers are selling these things every day and they have their gain and loss.

(The amendment was agreed to.)

Dr. ADAMS. On page 69, line 2. The proposal that I am now making is in the case of nonresident aliens not to compel returns before the 15th day of the sixth month following the close of the fiscal year, to give them three months longer within which to make returns.

The reason for that is, in the first place, that they ought to have more time, I think, and because we are very desirous of encouraging aliens to make returns. Most aliens do not make returns. Their tax is simply collected at the source.

This has been asked for by the men who superintend the making of the returns of most of the important aliens. They say it is very difficult, that they need a longer time. The Government is interested in getting reports from aliens. We have no way of forcing a report. If they do not do it we probably lose the tax. We can not compel them. The only way we can do is to collect the tax at the source.

Senator REED. Let us hear the amendment.

Dr. ADAMS. Page 69, line 6, after the period insert the following:

"In the case of nonresident aliens returns shall be made on or before the 15th day of the sixth month following the close of the fiscal year, or if the return is made on the basis of the calendar year, then the return should be made on or before the 15th day of July."

(Amendment agreed to.)

Dr. ADAMS. Page 257, paragraph 3, dealing with stamp taxes, the proposal is to strike out the following words:

"Unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof."

This relates only to no-par value stock. The present law is that on par value stock the tax shall be 2 cents in the transfer per hundred dollars—"on each $100 of face value or fraction thereof."

Line 3, page 258:

"And where such shares are without par or face value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share, unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof."

Most no-par value stock is actually worth very much less than $100 a share. There are some cases in which it is worth more; but the sole point is simplification. It is not worth the department's time to try to proceed to value the small proportion.

Senator REED. How do you want to amend it?

Dr. ADAMS. Strike out the following words: "unless the actual value thereof is in excess of $100 per share."

Senator REED. That brings up a very interesting question. Take a railroad stock that is worth 8 cents a share. You tax that on the par value. Here is a stock worth $500 a share, and it pays on its par value.

Dr. ADAMS. It pays the face value, whatever it is worth.

Senator REED. The question is whether the tax should not be on the market value of the shares where they have a market value, and where not, then upon the face value.

Dr. ADAMS. There is no such tax at the present time, and it would be impracticable, Senator. This is a stamp tax, you know, of 2 cents a share.

I am asking you to strike that out because it is so unimportant.

The CHAIRMAN. Is it the pleasure of the committee to agree to the amendment? [After a vote.] It is agreed to.

Dr. ADAMS. Page 258, line 12, after the word "deposited," insert the following words: "nor upon mere loans of stock or the return of stock so loaned."

The CHAIRMAN. What is the purpose of that?

Dr. ADAMS. The tax at this point is upon transfers of stock. This is a situation that is constantly arising. A man, for instance, we will say, in San Francisco wants to sell some stock on the New York stock exchange. He telegraphs them and says, "Sell my stock at 105," or whatever it is. The broker sells it. The shares of stock obviously belonging to the San Francisco man have not been delivered. The New York broker lends some of his own stock to the man who has bought in order to make delivery. When the customer's stock comes on he takes that from the customer in lieu of his stock which he has delivered. We get at the present time two transfers. The loan of the stock by the broker to the customer is deemed to be a transfer.

Senator SMOOT. If that is the practice, there is no question but what the amendment should be agreed to.

Dr. ADAMS. It is the practice.

The CHAIRMAN (after a vote). The amendment is agreed to. What is the next, Doctor?

Dr. ADAMS. On page 305 there is an amendment introduced at the request of the Treasury Department in lines 15 to 25 to which the Attorney General objects, and the Treasury Department asks you to strike out. It provides merely that notice shall be given by the clerk of the court, and the Attorney General says that those people are so overloaded that he does not want to ask them to do it.

The CHAIRMAN. If there is no objection, it will be stricken out. What is the next?

Dr. ADAMS. On page 307 of the bill you have a section dealing with personal service corporations. In case the present method of taxing personal service corporations is deemed invalid or held to be unconstitutional, we say they shall be taxed as ordinary corporations.

There are a number of little changes. The first one is in line 16. All of these you can very safely tell me to make except one.

The CHAIRMAN. If there is no objection, Dr. Adams will be authorized to embody those amendments in the bill as made up.

Dr. ADAMS. The first one is changing the three months period to six months, simply because of the uncertainties about when the adjudication is absolutely final.

The CHAIRMAN. That is agreed to, without objection.

Dr. ADAMS. Line 17 is a mere verbal matter.

Here is the point of substance: If the personal service corporation method of treatment is declared unconstitutional this section directs us to impose a regular corporation tax. I am suggesting the following method of dealing with it: On page 307, line 19, after the period, insert:

"In case the owners of less than 50 per cent of the outstanding stock or shares in such corporation file claims for credit or refund of taxes paid under subdivision (e) of section 218 of the revenue act of 1918 before the expiration of six months from the date of entry of decree upon such final adjudication, the amount of tax herein imposed upon such corporation shall be that proportion of the total tax as computed under sections 230 and 301 of the revenue act of 1918 as in force prior to the passage of this act, which the number of shares owned by such shareholders or members bears to the total number of shares outstanding."

That is to say, if less than half of the stockholders insist upon making this change and ask for a refund, they shall be permitted to get their refund; but the extent to which the corporation pays shall be equal to the stockholders' interest who have not asked for a refund. The old tax shall stand in lieu of a new tax.

The CHAIRMAN. If there is no objection, Dr. Adams will insert that amendment in the bill.

Dr. ADAMS. I have a new provision with relation to claims for refund of taxes in the Treasury Department. It is a thing that you can pass judgment upon very quickly. The proposition is this: The new budget bill practically gives the right to a final determination on all claims against the Government.

It puts it in the hands of the Controller General. He has the final say on all claims. The question is whether you want him to have the final say on all these technical tax questions. In other words, you have a bureau up there which costs five, six, seven, or eight million dollars a year. It is technical in the highest extreme. I can not think of the Controller General performing that work satisfactorily without duplicating the machinery already provided.

I have a suggested amendmen to go on page 310, line 5. It is a copy of the language of similar acts, and it reads as follows:

"In the absence of fraud or mistake in mathematical calculation the finding of facts in and the decision of the commissioner upon (or, in case the Secretary of the Treasury is authorized to approve the same, the decision of the commissioner or the Secretary upon) the merits of any claim presented under or authorized by the internal-revenue laws, shall not be subject to review by any administrative officer, employee, or agent of the United States."

Senator REED. I think that it all right.

(Whereupon, after informal discussion, at 1.30 o'clock p. m. the committee adjourned until to-morrow, Friday, September 16, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

FRIDAY, SEPTEMBER 16, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m. in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Sutherland, Simmons, Gerry, and Reed.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John H. Walker, Chief, Legislative Drafting Service of the United States Senate; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. I would like to ask reconsideration of paragraph 1, page 12, line 20, as there have been amendments suggested to me.

(After reconsideration, the committee failed to agree to the House amendment.)

Senator SMOOT. The Manufacturers' National Tax Committee met the other day a number of the members of the committee and made short statements, and at the request of those of the committee present they now submit a brief asked for by those present, and I shall ask, Mr. Chairman, that it be made a part of the record.

The CHAIRMAN. It will be inserted.

(The brief of the Manufacturers' National Tax Committee referred to and submitted by Senator Smoot is as follows:)

BRIEF IN SUPPORT OF PROPOSED "SMOOT PLAN" AS A SUBSTITUTE FOR THE HOUSE TAX BILL, H. R. 8245.

SEPTEMBER 16, 1921.

THE FINANCE COMMITTEE,
Senate of the United States.

GENTLEMEN: The members of your honorable committee deputed to receive and hear the committee of 50 of the Manufacturers' National Tax Committee expressed the wish to have briefed for their benefit the proposal of the distinguished Senator from Utah and urged as a substitute by the petitioners for the pending House tax bill.

Your petitioners, responsive to this request and appreciative of your courtesy, beg to submit:

1. Their representative character.
2. Their objection to the House bill.
3. The terms of the Smoot plan.
4. Their reasons for approving the same.

1. THE REPRESENTATIVE CHARACTER OF THE PETITIONERS.

The committee is composed of representatives of National, State, and local industrial and commercial associations, spontaneously expressing the widespread manifest dissatisfaction with the provisions of the bill passed by the House. The various organizations participating were impressed with the public statement of the Smoot plan as the only constructive substitute proceeding from an authoritative source and obtaining wide consideration. The conference

preceding presentation to your honorable committee crystalized the general dissatisfaction directed against the House measure and the widespread local and trade approval resulting from the study by various business groups and trade organizations of the Snyder plan. The organizations participating were estimated by the representatives on this committee to voice the opinion of substantially 100,000 members, with a normal employing capacity of approximately 5,000,000 of persons.

They have reason to believe that they are probably the first group of petitioners who have appeared before any committee of Congress charged with the levy of taxes in support of a proposition that a tax be levied against themselves.

2. OBJECTION OF PETITIONERS TO THE HOUSE BILL.

Your petitioners object to the House measure because:

(1) It does not afford substantial relief from the onerous, inequitably distributed, and unsatisfactorily administered provisions of the existing law which, under the pledges of both parties, they were reasonably entitled to expect. It is in form and substance a perpetuation of the provisions of the existing law from which relief was pledged by both parties and which the President called an extra session expressly to secure.

The Republican platform declared that "sound policy equally demands the early accomplishment of that real reduction of the tax burden which may be achieved by substituting simple for complex tax laws and procedure; prompt and certain determination of the tax liability for delay and uncertainty; tax laws which do not, for tax laws which do, excessively mulct the consumer or needlessly repress enterprise and thrift." (Republican platform, 1920.)

President Harding, in his first message to Congress, April 12, 1921, called the attention of that body to the fact that—

"We are committed to the repeal of the excess-profits tax and the abolition of inequities and unjustifiable exasperations in the present system. * * * 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."

The Democratic platform declared:

"The continuance in force in peace times of taxes devised under pressure of imperative necessity to produce a revenue for war purposes is indefensible and can only result in lasting injury to the people. The Republican Congress persistently failed through sheer political cowardice to make a single move toward a readjustment of tax laws which it denounced before the last election and was afraid to revise before the next election." (Democratic platform, 1920.)

The House bill affords no relief for the year 1921, in the most depressing period of American business, from those taxes specifically condemned, from those demonstrated to be unproductive, and continues to retain invidiously discriminating war excise taxes condoned in debate at the time of their enactment only because of the pressing necessity to obtain revenue for the national defense and intended to restrict forms of production which the employment of thousands of workers requires to be promoted and restored in time of peace.

(2) The House bill neither simplifies nor decentralizes the administration of the law, makes but slight contribution to its recognized and injuriously operating defects. It seeks no new source of revenue but relies upon those which have been the continuing subject of criticism, complaint, and condemnation. It sets up no practicable body of final tax adjustment or collections and to enlarge the revenue of Government and finally determine the vexatious and long-continuing disputes over back taxes, which would relieve the credit strain upon hundreds of industrial concerns and immediately enlarge the national revenue.

The House bill retains more than thirty sources of revenue many of which are the notorious subjects of private and public criticism. It does nothing to relieve the distant taxpayer in securing a less expensive and tedious correction of assessment. He must still seek tax justice at the Capitol; it is not localized for him. No means of expediting the vast outstanding claims between the Government and the taxpayer, now frequently three years in arrears, is suggested. All reduction of the immediate burden upon productive enterprise is set forward in the future, when every responsible business man had reason to believe that the primary purpose of the special session was to afford financial

relief and administrative improvement in the present year. Far from repealing or modifying the terms and administration of a tax system universally condemned by all classes and both parties, the House bill perpetuated the most objectionable principles of the existing system, and thereby makes likely their permanent incorporation into our taxing system.

American business is therefore profoundly disappointed and disheartened by the prospect presented in the House bill. It does not seek to avoid its necessary burdens; it seeks only that they should be equitably distributed, made capable of intelligent understanding and simplified administration.

3. THE TERMS OF THE SMOOT BILL.

The proposal of the Senator from Utah, as understood by your petitioners, would derive all Federal revenue from six sources, comprising personal and corporate income taxation at the present rate, save for a maximum surtax not to exceed 32 per cent, the substantially demonstrated productive maximum; tobacco taxes at the present rate; inheritance taxes at the present rate; import duties in terms of the pending measure; and a tax upon finished commodities at a single point, when consumed or used without further process of manufacture, at a rate not to exceed 3 per cent. The proposal to become effective upon its enactment and to repeal all other existing taxes.

To express the principle here stated for the purpose of obtaining a working definition in terms of the excise provisions of the present law, the levy on finished commodities would read substantially as follows:

"That there shall be levied, assessed, collected, and paid upon every commodity manufactured, produced, or imported, when sold, leased, or licensed for consumption or use without further process of manufacture, a tax equivalent to — per cent of the price for which such commodity is sold, leased, or licensed; such tax to be paid by the manufacturer, producer, or importer."

For the purposes of practical administration, there would be excepted from the operation of the proposal all operations where the gross sales were less than $6,000 per annum. These exceptions, under the estimates of the Census of Manufactures and the Department of Agriculture, would exclude the mass of small agricultural and industrial producers, while the inclusion of the importer and various forms of larger production in addition to the manufacturer, by widening the taxing base, enlarges the assured yield of revenue, which, however, would primarily and largely fall upon the manufacturer.

Your committee's first inquiry naturally is, What revenue may be anticipated from such a proposal? With respect to the first five sources of revenue, to wit, income taxes, both personal and corporate; tobacco; inheritance, and import duties, your honorable committee has the most authoritative estimates, which we submit are substantially as follows:

From personal and corporate income tax, with a maximum surtax of 32 per cent, including the corporate income levy at the present rate of 10 per cent	$1,275,000,000
From tobacco taxes at the present rate	255,000,000
From inheritance taxes at the present rate	150,000,000
From import duties, pending bill	400,000,000
From proposed manufacturers' tax, maximum 3 per cent	1,200,000,000
Total	3,280,000,000

The estimated yield of the manufacturer's tax is predicated upon the Census of Manufactures of 1919, giving the gross sales value of manufactured articles at substantially $62,500,000,000. Allowing for exception and shrinkage, the taxable sales of finished commodities under the Smoot proposal are estimated only at $40,000,000,000, and this is exclusive of the further body of taxable sales included under the terms production and import, and thus the widest margin is allowable for the Treasury estimate, with a reasonable likelihood of a 2 per cent tax not only affording the revenue required but allowing a reasonable margin for contingencies.

The Smoot plan, therefore, is, in brief, the repeal of all war taxes, the retention of corporate and personal income taxes at the present rate, the surtax reduced to the point of demonstrated efficiency, the retention of tobacco and inheritance taxes, the levy of import duties in pending terms, and the remainder of Federal revenue secured by the levy of a maximum 3 per cent tax on articles imported, produced, or manufactured at the point where they are sold for final use or consumption without further process of manufacture.

4. THEIR REASONS FOR APPROVING THE SAME.

Your committee favors the essential features of the Smoot plan because:

(1) It assures an abundant and reliable body of revenue collected at a single point, the burden of which is equitably distributed over a large body of producers, is definitely ascertainable, and at once provides the Government with current revenue, and may be currently charged off the taxpayer's books.

(2) It is simple of understanding and administration. It involves no new principle or practice of administration, but is defined in terms of existing excise taxation, pursues its forms in rule and exception. It can be efficiently administered under existing experience, and, by limiting the sources of revenue, simplifies the excise policy of the Government.

(3) Without lessening the amount of revenue, it removes the burden of invidiously discriminating war taxation from selected industries upon whom it was imposed for the purpose of limiting particular production as well as raising revenue. The reason for such limitation having expired, the policy should die with it, or it should be a popular tax because its amount is definite and certain and its relation to costs easily calculated by the mass of buyers of average intelligence. It can not therefore be made an excuse for unduly enhancing price or a mask for inexcusable extortion.

(4) It keeps the promise of both political parties by affording the means without loss of indispensable revenue of reforming the excise system, abandoning the taxation of arbitrarily selected groups, and repealing immediately the whole system of war taxation, hurriedly concentrated where it would obtain a return with little regard for the injustice inflicted upon individuals or industries, and substituting therefor the beginnings of an equitable system spreading its burdens over the great body of taxpayers. It can neither cumulate nor pyramid. It is a single tax, definite in amount and applied at a specific point, the determination of which point is a question of fact and not of law.

For these and other reasons, which the experience of the committee will multiply, we sincerely and earnestly urge upon your honorable body a favorable consideration of this proposal.

All of which is respectfully submitted.

By the executive committee of the Manufacturers' National Tax Committee.

JOHN E. EDGERTON, *Chairman,*
President, National Association of Manufacturers.
CHARLES E. HANCH,
National Automobile Chamber of Commerce.
FREDERICK C. HOOD,
Hood Rubber Co.
C. B. STIVER,
Iowa Manufacturers' Association.
SAUL ROGERS,
National Association of Motion-Picture Industry.

NEW YORK, *September 2, 1921.*

Hon. REED SMOOT,
Senate, Washington, D. C.

MY DEAR SENATOR: Supplementing my letter of yesterday, there is one further phase of the revenue bill which I wish particularly to call to your attention. It is the proposed elimination of the clause in parentheses in paragraph 2 of subdivision (a) of section 214 (also sec. 234), reading as follows: "(other than obligations of the United States issued after September 24, 1917)."

The effect of this amendment, retroactive for 1921, would approximate 1 per cent interest loss to original Liberty bond subscribers who are now paying 6 per cent and receiving, of course, only 4¼ per cent on their bonds. At the present time the interest paid on the Liberty bond loans can be deducted from gross income, and this advantage has made it possible for many subscribers to carry their bonds up to the present time.

It may be that they should be forced to sell at this time, but even so they should not lose the benefit of the deduction which they have relied upon in carrying their bonds through the present year. This would be a very severe hardship, involving a relatively large amount of money to men who can least afford to lose it.

I am, with high regard, very truly, yours,

ROBERT R. REED.

P. S.—While I believe the present provision should be retained, you might wish to consider inserting after the figure "1917" the words "in the hands of the original subscriber or a member of his family, including such obligations acquired in exchange for or concurrently with the sale of other such obligations."

R. R. R.

The CHAIRMAN. Dr. Adams, what have you next to submit?

Dr. ADAMS. On page 21, lines 23 and 24, and the paragraph relating to (b). This is capital gain and capital loss provision, and is a very difficult and important section.

The meaning of all this is to put a limit upon capital gains and capital losses. The limit in the House bill is 12½ per cent, but that was the House rate on corporations, and it was arranged so as to fix the same rates on gains from capital assets as was put on corporations; under a corporation rate of 15 per cent that would be 15 per cent. That has a number of difficulties. For instance, you use the amount $29,000 in order to get the group of taxpayers who would be subject to a tax above 15 per cent, but that method is not exact. Moreover, this section gives no benefit to persons whose tax is less than 15 per cent.

In short, I have devised a different method, which seems to me altogether simple and escapes the objections which have been entered against this paragraph. And I shall read it, if I may, and state the new method.

Senator LA FOLLETTE. Is what you are going to read a substitute?

Dr. ADAMS. Yes, sir. It would read as follows [reading]:

"Page 21, strike out lines 23 and 24, and page 22, strike out lines 1 to 14, inclusive, and in lieu thereof insert the following:

"'(b) In the case of any taxpayer who during any taxable year derives a capital net gain or sustains a capital net loss, such capital net gain or capital net loss, as the case may be, shall, under regulations prescribed by the commissioner with the approval of the Secretary, be distinguished from the ordinary net income and stated separately in the taxpayer's return. In either such case, only 40 per cent of such capital net gain or capital net loss shall be taken into account in determining the amount of the net income upon which the tax imposed by sections 210 and 211 or by section 230 of this title is computed, assessed, collected, and paid, in such manner that, (1) if the taxpayer has derived a capital net gain, such tax shall be computed, assessed, collected, and paid upon the sum of the amount of his ordinary net income plus 40 per cent of the amount of his capital net gain, or (2) if the taxpayer has sustained a capital net loss, such tax shall be computed, assessed, collected, and paid upon the amount of his ordinary net income less 40 per cent of the amount of his capital net loss. Where the capital net gain or the capital net loss is less than $5,000, the method of taxation prescribed in this section shall be optional with the taxpayer.'"

All that is done for this reason: The present section is rather artificial in starting at $29,000 or $39,000 or any other amount. This substitute gives an allowance, and makes the section apply, to everybody. The 40 per cent proposition has been adopted for this purpose: The maximum rate that anybody can pay is 40 per cent; 40 per cent of 40 per cent is 16 per cent. That would make the rate 16 per cent to everybody, and would affect everybody who has capital net gain or loss.

This ought to be remembered: You are doing, if you do this, a very radical thing in respect to losses; that is, the real question you ought to have in mind here is the policy and whether you want to do it at all or not.

Suppose a man has an income under the existing law of $100,000; and suppose he has a capital net loss of $95,000. Under existing law he would pay taxes only on $5,000 at an average rate of 1 or 2 per cent, but under this law he would start out with his $100,000 ordinary net income, and under the proposal that I am making he would only get an allowance of 40 per cent of his net capital loss of $95,000 which would be $38,000. In other words, he would only be able to deduct $38,000, and that would leave him taxed on an income of $62,000. He only makes $5,000. But what I am suggesting is easier than the proposal in the present bill. The question is simply this, if you start in to reduce the rates on capital gains—if that logic is sound—should you not deal similarly and with equal hand with losses; but you are going to get this situation: Many taxpayers say you ought not to take capital gains into account at all. Under the British plan you do not take them into account. You are taking an intermediate position in this proposal. I do not care what you do on it; I

have not any personal interest in this one way or the other, but the amendment which I am suggesting allows a larger part of the loss than the provisions of the House bill, besides being infinitely simpler.

Senator REED. What did we do before this amendment of the House came in?

Dr. ADAMS. Taxed him $5,000 in the case I gave.

Senator REED. You mean, take the present law, if there is a capital net gain, what do you do with it?

Dr. ADAMS. You do not recognize it separately.

Senator REED. You call it income?

Dr. ADAMS. We call it income, and tax it at the full rate.

Senator REED. The next year he has a loss and he has no income and he pays no tax; that is the way it is now. If he has a net loss he pays no tax.

There may be objections to that on one feature of it, but when it is proposed that a man has a gain he shall only pay on 40 per cent, but if he has a loss of 100 per cent he shall nevertheless pay on 40 per cent of his capital, it seems to me, is utterly bad.

Senator REED. How do you interpret the House bill?

Dr. ADAMS. The House bill sets aside ordinary loss and gain. If it is capital net loss you can not get an allowance of more than 15 per cent. The House bill deals with losses and gains in exactly equal measure.

Senator SMOOT. I think when a man loses $100,000 he is entitled to at least subtract that from whatever gains he may have during that year, and not put it over on another year or anything like that. I should think it ought to be within the year, but it does seem a man ought never to be taxed on any part of his loss. His tax now is on his gains. But if a man loses $90,000 and he has gained $100,000, he is only $10,000 ahead. That is the practice to-day. It is true that if everybody was successful in business and there were no losses at all, the present law does prohibit in many, many cases the sale and transfer of property at increased prices because the tax imposed upon it would be so heavy he would not make the transfer.

Senator MCLEAN. Why can you not cover gains without applying the same rule to losses?

Dr. ADAMS. I can. I think it is unfair. Our people must have some philosophy and some principle. This proposal is not a largess.

Senator REED. You are taxing something. When a man gets $100,000 he has something to tax, but when a man loses $100,000 you are taxing a vacuum; you are taxing something that does not exist at all.

Dr. ADAMS. People say that is not a vacuum; that capital transactions ought to be taken into account.

Senator REED. If I make $100,000 on a piece of property this year, I have $100,000 to pay taxes out of and to pay taxes on. But if I lose $100,000 in that transaction I have nothing to tax and I am $100,000 worse off than nothing on the transaction, it seems to me.

Senator DILLINGHAM. You are taxing the loss.

Senator REED. Yes; you are taxing something that does exist in one case and taxing something that does not exist in the other.

I wanted to suggest this: I do not know that my suggestion is sound—but I think this is true of the ordinary business man—he makes a loss, he actually loses money and reduces his capital. Is there not some plan by which it could be worked out that you could average the gains and losses over a period of years—for instance, if the tax was levied on a period of three years instead of one year; then if a man made money this year and lost money the second year and made money the third year——

Senator WATSON (interposing). You mean to wait until the end of the third year?

Senator REED. No; I do not. The average could be struck. The question is this, whether there could not be a period of adjustment fixed? A man would pay taxes in the meantime, and then it could be adjusted every three years or every five years.

Dr. ADAMS. They have a three years' average in Great Britain and have had it for many years. It has been many times on the verge of being repealed. It is as popular as can be with the taxpayer while prices are rising, but as soon as they begin to fall and they begin to pay on the average of the profits of that particular year, it is entirely obnoxious. I think our net loss provision is a better way than the English average, because the average means you get much higher than your actual earnings. They are hitting at that in England. We have the net loss provision, which gives something near what you want.

Senator REED. Did you draw that amendment?

Dr. ADAMS. I did; and I had it down here one day to submit to you, but you were not here and I took it back, and I will have to get it for you.

Senator SMOOT. I think I would like to vote to strike out the House provision, the entire section, beginning with line 23, page 21, down to and including line 14, on page 22. That leaves the law as it is to-day, and the law to-day taxes all capital profits.

Dr. ADAMS. And acknowledges all capital gains.

(Senator Smoot's motion was agreed to.)

Senator REED. On this subject, and before we leave it, I am firmly convinced that we have got to face the proposition that our laws as they now stand are stopping transfers of property altogether, and I think we might just as well see if we can not work out something at this time, if the committee is of the same opinion I am. I will illustrate that: A very prominent publisher in this country told me one day, with some degree of satisfaction, that he had bought a new building. It had been tied up for many years in litigation, and he had got it, and I think he had made $3,000,000 on the purchase. But he said, "I never can sell it." I said, "Why?" "Because I will give 80 per cent of my profits to the Government, and the result of it is I had better keep it in this form and bequeath it to my posterity and get the rent than to sell it and give it all to the Government.'

That I just cite as illustrative of the general principle.

Then, I think that the department down here, notwithstanding they were sustained by the Supreme Court, made a very great mistake in not fixing some period for valuation. They took 1913 as the basis of value, and they said, "We will find what the property was worth then, and we will treat that as its value."

But this rule as it is laid down now comes to this: Senator La Follette buys a farm in Wisconsin, perhaps an unproductive piece of land, 25 years ago and pays $2.50 an acre and holds it. It rises to the value of $100 an acre. Senator McLean goes to-day and buys a farm right alongside of Senator La Follette's, identical in character, and pays $100 an acre. In the meantime Senator McLean's ground has changed hands a half dozen times, and the Government gets the tax. You have two pieces of property absolutely identical. If Senator McLean sells to-morrow at $100 an acre he pays no tax, because he makes no profit; but if Senator La Follette sells to-morrow at $100 an acre he pays a tax at the rate of $97.50 per acre.

Dr. ADAMS. There are two questions involved. Senator Reed is troubled by an entirely different question; that is, the method of computing invested capital, which is quite distinct under the present law.

On this other point it is simply a question of policy here. It is perfectly easy to limit it to gains only, and that would do it in a simple, expeditious, clear cut, uncomplicated way.

The obnoxious part of what I said was in suggesting to apply the same principle to capital losses as to capital gains.

Senator REED. What would that make the tax, if you adopted your rule? A man sells an oil well and makes $100,000. What would he pay under your rule on that transaction?

Dr. ADAMS. I can not tell; it depends upon many things, but whatever it would do, it would do this——

Senator MCCUMBER (interposing). What are you taking as the basis?

Dr. ADAMS. Your maximum tax as an individual under the income tax is now 40 per cent. You have done a great deal for the situation by limiting taxes to 40 per cent, whereas the maximum has been 73 per cent.

But getting back to the point, the method I gave would make the maximum tax 16 per cent instead of 14. It could not go beyond 16 per cent on his profits.

Senator MCCUMBER. He makes $100,000 profit, and the most he could pay would be $16,000 to the Government?

Dr. ADAMS. Yes. What we would do is this: You have cut that down to $40,000. Assuming he would pay the maximum rate—which he can not do—16 per cent, and that computed is $16,000. In other words, your maximum tax under any situation would be 16 per cent on capital gain.

Senator MCLEAN. Mr. McCoy, what would be the result on the returns?

Mr. MCCOY. I rather think it would increase the taxation, because a great many transactions would be made that otherwise would not.

Senator MCLEAN. It would rather stimulate transfers?

Mr. MCCOY. Yes.

Senator SMOOT. Section (b), page 28, we put in the existing law to take care of just such cases as were recited here by the Senator. [Reading:]

"(b) In the case of a bona fide sales of mines, oil, or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest."

That is the present law, and it was put in to take care of oil wells and mines.

Senator CURTIS. I move to adopt that part of the amendment proposed by Dr. Adams, leaving out the loss provision.

(The motion was agreed to.)

Dr. ADAMS. The amendment, as I gathered from Senator Reed, page 34, after line 10, suggested to ascertain whether this phraseology would be satisactory [reading]:

"Income received (from sources without the United States)"—

Which I think should be omitted—

"by an alien representative of a foreign country."

That would confine it to alien representatives of a foreign country.

Senator CALDER. Would that take in the case of a man who lived in Canada and worked in New York?

Dr. ADAMS. This refers solely to diplomatic and other representatives.

The CHAIRMAN. Why do you not say "diplomatic and consular representatives?"

Dr. ADAMS. The committee adopted the phraseology of Senator Reed. It was dictated, and this I gathered from Mr. Walker, is the substance of that. The matter is out of my hands and in your hands. I do not believe this is very much worth while, to tell you the truth; I do not think it covers the problem. The problem is wider than the official representatives of a foreign country.

The CHAIRMAN. How would it do to leave it out to be put in on the floor of the Senate?

Dr. ADAMS. The question is, what is an alien representative?

The CHAIRMAN. That occurs to me at once, "What is an alien representative?"

Dr. ADAMS. Then, furthermore, I do not think the problem is primarily relating to income from sources without the United States. The question is very largely income received from sources within the United States. Foreign governments have different classes of laws relating both to income within their country and to income without their country, relating both to ambassadors, ministers, and to consuls, and so on; they vary in their character and extent. Personally I would see no unfairness in dealing with representatives of foreign countries precisely as they deal with ours. That would be a very elastic proposition. This would help, but I doubt if it would meet all of our questions.

Senator REED. Objection was made that some of these men came over here and embarked in business ventures which might not be of an extensive character in this country. Consuls and men of that class might be engaged extensively in business and make money here, and we did not want to exempt them from doing business in the United States but on their foreign income, for instance, upon salaries; and to meet that I dictated what is now before us, and the reason for putting in "alien representatives" was because it was said that in many instances a foreign country might have as representative a citizen of the United States, in which case he would be exempted, if we did not use the word "alien." I would not want to go beyond this.

The CHAIRMAN. Without objection it will be passed over and be brought up later in the committee and on the floor, if need be.

How do you do now about foreign representatives?

Dr. ADAMS. There has been the practice of letting them in under general international law quite extensively on pretty nearly everything. The question came up in large cases, and it is before the solicitor's office, and we find that even the law on this subject is doubtful. Chief Justice Marshall relates, contrary to the principles of some of the prominent writers, that they ought to be taxed on everything just the same as any resident.

Senator CURTIS. It seems to me it ought to be taken up with both the State and Treasury Departments.

Dr. ADAMS. Their concessions go to all different points. That was the elasticity of it. They give it to consuls in some countries and do not give it to consuls in other countries.

The next is page 39, at the end of line 25, strike out the semicolon and insert in lieu thereof the following: "*and provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowances for depreciation and 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 fair market value as of March 1, 1913."

This is a question illustrated by the case of a street railway property which went into the oil business, got a very fortunate well, and while it had some profit from the street railway and power ends of the business, sustained a loss based on its discovery value in the oil business. The question is whether a loss based upon discovery value, which is a statutory thing, and not a true loss should be permitted to wipe out profits from other branches of the business, and this method was suggested for taking care of it.

You have a natural depletion, which is cost or market value as of March 1, 1913, and then you have the statutory depletion, which is discovery value. If the whole depletion deduction exceeds all the income from the property, it is suggested that you do not allow the deficit calculated on this discovery to reduce the income from other kinds of property other than oil property.

Senator MCCUMBER (presiding). If there is no objection, it is agreed to.

Senator REED. You gave us an amendment here in which you proposed that capital assets or profits should be taxed and losses should be accounted for. You said that would amount in a maximum to 16 per cent.

Dr. ADAMS. The present law shall not exceed 16 per cent.

Senator REED. Why not change that to 20 per cent instead of 16 per cent, so that the law do not seem to lay down two rules?

Dr. ADAMS. That certainly would do no harm.

Senator REED. What is that section?

Dr. ADAMS. Subdivision (b) of section 211, page 28, lines 9 to 15.

The difference between 16 and 20 is rather a crucial matter, perhaps. Your point is all right, Senator Reed. Neither can go beyond 16. There is no objection; if you are going to adopt 16 for 1, adopt 16 here.

(The motion to change the figures from 20 to 16, page 28, line 14, in order to make it conform was agreed to.)

Dr. ADAMS. Page 43, line 2: This is the case of involuntary conversion of property, where ships are sunk and that kind of thing, it being proposed to insert at that point the following sentence [reading]:

"The provisions of this paragraph prescribing the conditions under which a deduction may be taken in respect of the proceeds or gains derived from the compulsory or involuntary conversion of property into cash or its equivalent shall apply to the exemption or exclusion of such proceeds or gains under prior income or excess profits tax act."

The thing which is given here as a deduction is, under existing law, simply omitted from gross income. It is not, in my opinion, in some details properly safeguarded, and I want to apply these safeguards and conditions to the same thing.

Senator MCCUMBER. If there is no objection, it is agreed to.

Dr. ADAMS. Page 48, lines 5 to 8: This is the foreign traders. It is proposed to strike out paragraphs 5 and 7. Paragraph 5 relates to "gains, profits, and income from the ownership or operation of any farm, mine, oil or gas well, other natural deposits, or timber, located in the United States, and from any sale by the producer of the products thereof."

This says that the gains or profits and all that kind of thing shall be taxed in the United States if the property is here. That is a sound rule and will go without saying in the average case. There are some cases where possibly it ought not to apply. For instance, we have a number of important American business enterprises at the present time owning mines in Canada which have their factories over here and bring this stuff over. This would deprive us of any tax in that case.

Senator REED. The present language?

Dr. ADAMS. The present language would. The present language puts favor on the situs of the mine or property; that is the general rule and will be followed, but there is occasionally a case where the factory is located elsewhere or where the element of location is very important, and I think we should be silent on it.

This present thing is what might be called a natural rule applied absolutely in every case. There will be no trouble about the way the average case is decided; it will take care of itself. But I think there is a case where you want to temper it.

The CHAIRMAN. If there is no objection, the amendment will be adopted.

Dr. ADAMS. Much the same argument relates to paragraph 7, which goes without saying, except in a few cases where it ought not to do. [Reading:]

"Gains, profits, and income from the sale of personal property, both purchased and sold, or both produced and sold by the taxpayer within the United States."

I suggest that those two paragraphs be stricken out, with the similar paragraph on page 49, which relates to the foreigner and applies the same rule to business without the United States. My suggestion is that this be stricken out to leave it a little more elastic.

The CHAIRMAN. If there is no objection, the suggestion of Dr. Adams will be favorably acted upon.

Senator SUTHERLAND. Does that give preference to treatment to foreigners?

Dr. ADAMS. I think it has no effect either way on that, and moreover the principal point you have in mind will be covered by what I am going to read. I have to suggest an amendment to subdivision (e) on page 70, to read as follows [reading]:

"(e) Items of gross income and expenses, losses and deductions, other than those specified in subdivisions (a) and (c), shall be allocated or apportioned to sources within and without the United States under rules and regulations prescribed by the commissioner with the approval of the Secretary. In the case of gains, profits, and income derived from sources partly within and partly without the United States, the portion attributable to sources within the United States may be determined by process or formulas of general apportionment prescribed by the commissioner with the approval of the Secretary, which shall be designed to attribute to sources within the United States such part of the apportionable income as might reasonably be expected if the business investment and activities of the trade or business (including production and sale, transportation and services) within the United States were independently owned and conducted. For the purposes of this section, gains, profits, and income from (1) transportation or other services rendered partly within and partly without the United States, or (2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits, and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall (for the purpose of this section) be treated as derived entirely from the country in which sold."

Senator CURTIS. A word, what does that mean?

Dr. ADAMS. In a word, we say this: In the case of a manufacture in one country and sale in another, the thing is split up and divided by general rule. You can not have it too general, but establish the principle so that the courts will have something on which to control. The present proposal leaves it absolutely in our discretion. Then, with respect to purchase in one country and sale in another, where no money is involved, in order not to discourage purchase in this country, and I make the income follow wholly in that case the place of sale. That is the reason, principally, why I redictated this, because that point was disquieting to foreigners, and our own people are being frightened for fear that the proposal as it passed the House might lead to some taxation of purchases in this country, though it was never so intended.

I want to make it clear that the mere purchase at a place shall not give rise to any taxable income at that place; in other words, a foreigner may come over here and buy and not be subject to a tax. And you have always to remember the effect——

Senator MCCUMBER (interposing). Suppose he comes over here and buys, and sells in a foreign country?

Dr. ADAMS. He will be subject to tax—if he buys and sells—because the thing is put on sale.

Senator MCCUMBER. I said, "Suppose he comes over and buys in this country and sells in a foreign country?"

Dr. ADAMS. I think that is what you want to encourage—certainly you do want to discourage it.

Senator MCCUMBER. This is the very point I brought up and put before you the other day: Suppose a man doing business as an exporter in New York buys his goods in the United States, sends them to Brazil, sells them in Brazil. He makes his money in the United States, does he not?

Dr. ADAMS. So far as anything said here is attributed to sales made in Brazil.

Senator MCCUMBER. Do you mean to say that he escapes profits for the sales in Brazil?

Dr. ADAMS. You are talking, I think, about somewhat different sections. This applies only to aliens and foreign traders.

Senator MCCUMBER. I want to compare him with the American doing business. A delegation was to see me, and they presented the same case.

Dr. ADAMS. I have read it very carefully. It reflects on the whole section here. This deals with nonresident aliens, where they may be subject to the derived income. I am not opposing what they say. It goes to this whole foreign-trader proposition.

Senator MCCUMBER. If I remember their proposition it was this: They said, "Here is an American citizen buying American goods and exporting them to Brazil; that American citizen is taxed." Under your proposed law they say if a man from Great Britain comes over here and buys the same goods of American citizens and exports them to Brazil and sells them there the American pays the tax and the foreigner does not, and they consider that as an unfair competition. Is that true?

Dr. ADAMS. That is largely true, and their proposal is to be exempt from all profits derived from the export trade in order to encourage export trade. That is their proposal. This is a rather narrow section of the law, prescribing rather minutely rules and regulations by which a foreigner, for instance, doing business in this country, shall determine how much income is earned here and how much is earned abroad.

Your correspondents or friends challenge the whole treatment of foreign traders, and they want to wipe that out. But that is only involved incidentally, because this principally will affect aliens and foreigners; these rules will still have principal application to the foreigners and foreign corporatons.

Senator REED. Recurring to Senator McCumber's point, can you not take up his point?

Senator MCCUMBER. If it so operates, I would say it is a proper attack. I can not see why foreigners should have an advantage in doing business in the United States over the American doing business in the United States. His capital is employed here; his business is done here; he does just exactly the same as the American, and I can not imagine why you should grant him a release from taxation while you tax the American for doing the same business. If it affects the whole thing it seems to me the whole business ought to be changed.

Senator WATSON. Does this section you now propose give the foreigner the advantage over the American?

Dr. ADAMS. Senator McCumber's point is very distinguishably one of general policy, but it goes to the whole question of the exemption from taxation on profits derived from the export trade. It ought to be taken up as a big, broad, main proposition on that ground. What they ask for is that profits from sales made by everybody, particularly sales made by citizens and residents, should be exempt.

Mr. MCCOY. There is just a little conflict between Dr. Adams and Senator McCumber. Dr. Adams did not get Senator McCumber's point. If the foreigner is a nonresident alien and buys in this country and sells in a foreign country, he is not in this country and can not be taxed; his profits are not made here. If he is a resident alien, then he is taxed under the present law. The income is derived in this country, and he is taxed. But Senator McCumber stated if a foreigner would come to New York, live there, buy the goods and make profits in Brazil. The profit would then come back and would be taxed. The foreigner and American would be on a perfect parity. But if he is a nonresident alien, he is not in this country; his profit never comes to this country, and how can we tax it?

Dr. ADAMS. In a variety of ways.

Mr. MCCOY. He simply buys through an agent; we can not follow him to his own country.

Senator MCCUMBER. Evidently the parties who saw me and made that claim, take a different view. They take the view that where the profit is made in the

sale, and there is no profit until the sale is made and the real profit is in the sale, that where it is merely the purchase of goods and not the manufacture of them, they can have no profit in the manufacture, but only in the purchase. Then, under the ruling that the profit is made where the sale is made, when the sale is made in this foreign country, that this man, though he resides in New York, if he is a foreigner he escapes the tax.

Dr. ADAMS. I went over your memorandum this morning very carefully. The point made, in general, is as an attack on the general principle, perfectly right and sound. I have no objection if you want to follow the policy—taking a class of American citizens doing business abroad and giving one rule to them, but in this country taxing, in the case of an ordinary American, the profits on sales that he may make anywhere. The ordinary American pays a tax on profits anywhere and everywhere. If there has been in your mind any belief that we deal differently with a resident foreigner, a foreigner who lives here regularly, and an American citizen, we do not.

Mr. McCoy has corrected you on an important point. The resident pays taxes on all his income, wherever it arises. Your friend's attack is a different thing. You are going off on altogether wrong track. My own idea is to give the same privilege to everybody and say, "If you export stuff, however little you export or however much you export, if you export it and sell it and make a profit, let us exempt that in order to stimulate this very necessary export trade."

Senator REED. What are you going to do with this: Here is Senator McCumber, a citizen of the United States, buying goods in the United States and sends them to Brazil and making a profit on his transactions, and paying his taxes. Here comes a British concern wanting to compete in the British market and to use our goods in doing so. They get an agent in New York City who simply becomes their hired man. He goes out and buys these same goods and sends them to Brazil and pays no taxes to us whatsoever. The result is if the tax amounts to ½ of 1 per cent——

Senator MCCUMBER (interposing). He pays a big income tax in his country; so that would equalize that.

Senator REED. The British concern may pay in his own country, but would not they have an advantage? Do you think that would offset it?

Senator MCCUMBER. I think it not only equalizes the taxes, but, as a matter of fact, I think the British taxes are more.

Senator REED. I think you are right about that.

Senator WATSON. Doctor, did you offer that as a substitute for the whole section (e)?

Dr. ADAMS. I offered that as a substitute to the whole section.

Senator MCCUMBER. I want to say, Doctor, if the tax is the same upon the man who resides here who is a foreigner and who is doing business, I then can not see anything in what they have presented to me. I do not agree with them that if a person makes profits on exporting he ought to be relieved from tax.

Dr. ADAMS. It comes down to that. That is the detail of the general scheme. The point raised by your friends would be as to the propriety of including that whole scheme.

The CHAIRMAN. What is the pleasure of the committee?

Senator WATSON. I move that the substitute proposed by Dr. Adams be agreed to.

(After a vote:)

The committee has heard the motion, and it is agreed to.

Dr. ADAMS. The next change comes on page 58, line 8. It is proposed to introduce a new subdivision here dealing with taxation of estates, trusts, etc., to take care of profit-sharing trusts created by corporations for the benefit largely of their employees. The point is this: At the present time many corporations are creating trusts and making arrangements by which, if their employees contribute a certain amount of money, they will contribute a certain amount of money, too, for a certain length of time. Stock may be taken by the employees. There is some doubt as to whether those trusts, so created, would not be taxable in their entirety at the time they accumulated any income, and subject to surtax. It is proposed here to make it clear that these trusts shall not be subject to such tax if they are irrevocably trusts, so that the employer can not take the money back or base it on a contingency.

That comes in after line 8, on page 58. We are now going to put in a new section, section (f), as follows:

"(f) An irrevocable trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any such employee shall be taxable to him in the year in which it is so distributed or made available to the extent that it exceed the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits that part of the amount so distributed or made available as represents the items specified in subdivision (a) and (b) of section 216."

Those last mysterious references are to dividends which these corporations have received. It simply means that the exemption shall be carried along to the employees. It is for the purpose of encouraging them. Perhaps you gentlemen thought that estate trusts would not be taxable. They are properly taxable under the existing law.

Senator SMOOT. I move that it be adopted.

The CHAIRMAN. If there is no objection, it will be adopted.

Dr. ADAMS. The next change occurs on page 93, and is a question of insurance taxation. The present method of dealing with insurance companies is this——

Senator LA FOLLETTE. I wonder if I might bring up a small matter before we take that up.

The CHAIRMAN. Certainly.

Senator LA FOLLETTE. It is just a little matter affecting the bottle business. I want to read a short communication which I received this morning. It will take only a moment or two and then I shall be through. I will ask, first, unanimous consent to reconsider the vote by which we adopted that tax on yesterday.

The CHAIRMAN. The paragraph relating to carbonated water, etc., will be reconsidered at the request of Senator La Follette, by unanimous consent.

Senator LA FOLLETTE. The point that is made—and it seems to me a perfectly good one—is that as the matter is left they are taxed 50 per cent higher than their competitors are taxed. I can not present the matter to the committee better than by reading this letter which I received. It is just a little over a page long.

Senator SIMMONS. Who is it they say is their competitor?

Senator LA FOLLETTE. The cereal beverage people are their chief competitors. This deals with page 197, chiefly, although it runs over to page 198, paragraphs (b) and (d).

AMERICAN BOTTLERS OF CARBONATED BEVERAGES,
Washington, D. C., September 15, 1921.

Hon. ROBERT M. LA FOLLETTE,
United States Senate, Washington, D. C.

MY DEAR SENATOR: We feel that by the tax on carbonated beverages as passed by the Senate Finance Committee to-day a grave injustice has been done our industry. We feel that this is occasioned, of course, by your not being familiar with the facts, as we realize that you desire to put us on an equal basis with other beverages.

As you know cereal beverages and still beverages by the action of the committee to-day will be taxed 2 cents a gallon. The tax of 10 cents a gallon on sirup and 5 cents a pound on carbonic gas, which are the taxes paid by the bottler of carbonated beverages and the soda fountain, means that, figured on a gallonage basis, we are paying 3 cents a gallon, or, in other words, 1 cent more than other types of beverages which are competing with us.

One gallon of finished sirup will manufacture five gallons of finished beverage. The tax of 10 cents a gallon on sirup means, as you will see, that we are paying, with the sirup alone, a tax of 2 cents a gallon on our finished beverage.

A pound of gas will carbonate five gallons of beverage. Consequently with a tax of 5 cents a pound on gas it means that we pay a tax of 1 cent a gallon on the finished beverage.

With the tax of 2 cents on the sirup used in making a gallon of finished beverage and a tax of 1 cent on the gas used in manufacturing a gallon of finished beverage, you will see that we are paying 3 cents tax, where such drinks as orangeade, lemonade, grapeade, and limeade, and all cereal beverages are only taxed 2 cents a gallon.

When the Government experts wrote these paragraphs and placed a tax at 3 cents a gallon on still beverages, this rate was fixed because it made the tax on still and carbonated beverages equal.

This unfair situation could be easily remedied by the committee if it would eliminate entirely the tax on carbonic gas as provided by paragraph (e) of section 628. You will note that with this tax eliminated we would be relieved of 1 cent tax on each gallon of beverage and we would then be on a 2 cent basis like the others we have mentioned.

It seems to me this could be done very easily without any material loss of revenue to the Government. A tax of 5 cents per pound on gas was levied by the revenue act of 1917, and the figures of the Internal-Revenue Department show that slightly less than $2,000,000 was collected annually from this tax. The Treasury experts, I believe, estimate that this tax on carbonic gas will bring but $2,000,000 each year to the Government.

If you will do away with this, the 14,000 bottlers of carbonated beverages and the 110,000 fountains in the United States manufacturing carbonated beverages would then be placed on an equal basis of taxation with their direct competitors.

I feel sure that the committee does not want to put any extra burden on us, and I feel sure that if you will be kind enough to bring this matter to their attention that we may expect to have the small tax which would be collected from gas thereby stricken out. Will you please be so kind as to lay this matter before the committee?

Thanking you very much for the consideration and aid that you have given us, and assuring you that I will certainly appreciate your interest in this matter, I am,

Very truly, yours,

L. G. HEIBEL.

AMERICAN BOTTLERS OF CARBONATED BEVERAGES,
Washington, D. C., September 16, 1921.

The Hon. ROBERT M. LA FOLLETTE,
United States Senate, Washington, D. C.

MY DEAR SENATOR: Referring to statement made in my letter to you of even date relative to the amount of beverage which can be carbonated by 1 pound of carbonic gas, and which you have informed me was disputed by the Government experts, I wish to offer you the following explanation:

At 2 o'clock this afternoon I got in touch with Mr. J. W. Sales, of the Bureau of Chemistry, who is in charge of that bureau's investigations, analyses, and regulation of soft drinks for the United States Government.

Mr. Sales informed me that the Government's investigations throughout the country show that for the progressive, honest, and legitimate bottler the ratio of 5 gallons of beverage to 1 pound of gas is exceedingly fair and truthful. He stated that there are some bottlers who put up a poor type of beverage and one which the bureau is fighting that get as much as 7 gallons of carbonation to 1 pound of gas, but this is the maximum.

He stated further that there are many of the best-known drinks in the country, citing himself the instance of Clicquot Club Ginger Ale, which do not get but 3½ gallons of carbonation to a pound of gas.

He was very emphatic, however, in stating that healthful, wholesome beverages with a real food value such as those that are put up by progressive manufacturers can not be made with carbonation running less than 1 pound of gas to 5 gallons of beverage.

My personal experience in Madison on tanks filled and furnished to soda fountains is that we can fill on an average of seven 10-gallon tanks out of a 20-pound gas drum, which only gives us 3½ gallons of carbonated water to each pound of gas. To this the dispenser adds his flavored sirup, which makes the total gallonage only a trifle over 4 gallons of finished beverage to a pound of gas.

In our bottling plant we are able to carbonate 200 cases of beverages from each 50-pound gas drum. These cases are made up of twenty-four 7-ounce bottles which amounts to approximately 250 gallons of finished beverage. You will note that this means a 50-pound drum of gas to 250 gallons of beverage, or, in other words, 1 pound of gas to 5 gallons of beverage.

I have taken this matter up also with the office of the American Bottlers of Carbonated Beverages, which is located in Washington, and I find that their

statistics show an average of from 4½ to 5 gallons of beverage carbonated from each pound of gas.

I cite these illustrations in verification of the statement made in my letter to you and which you stated to me there was some dispute over.

I trust, Senator, that you will bring this matter to the attention of your committee, for it is particularly vital to us that we be put on an equal basis in matters of taxation with other beverages, such as still and cereal, which your committee yesterday placed on a basis of 2 cents a gallon.

I can not believe that the committee desires to do other than treat us as fairly as they have other beverages, and I feel that it was done because of the fact that you did not have the actual information relative to our trade.

We are not particular about the reduction in the gas tax. We would be just as willing to have the reduction come by lowering the rate of 10 cents a gallon now assessed on finished sirup. Either way will bring around the desired result which is, of course, a tax which will put 2 cents on each gallon of our finished beverage.

Thanking you very much for having taken the interest this morning of enlightening the committee regarding the facts and assuring you that I will appreciate your giving them this information, I am,

Very truly, yours,

L. G. HEIBEL.

Mr. MCCOY. I want to say in reference to one point that 1 pound of carbonic acid at 100 pounds pressure will carbonate 10 gallons of liquid; at the ordinary pressure it will carbonate 20 gallons. I have the report of the chemist here.

Senator LA FOLLETTE. It will take some convincing proof to make me believe that this statement is false, because I know the man who makes it.

(Informal discussion followed.)

Senator LA FOLLETTE. I am not able to state the chemistry of the thing. I will ask to have it passed over until this afternoon, since my statements have been contradicted by Mr. McCoy.

The CHAIRMAN. The matter will go over.

What is next, Dr. Adams?

Dr. ADAMS. The taxation of insurance companies.

The CHAIRMAN. Proceed.

Dr. ADAMS. This begins on page 93 and runs over to page 97.

The CHAIRMAN. Gentlemen, the committee will consider the question of insurance companies, a question which went over in order to permit Dr. Adams to conduct a certain investigation.

Dr. ADAMS. This scheme is applied to all insurance companies in the House bill. It substitutes for other taxes on them a tax on their investment income. It was devised for life insurance companies, and is not really suitable to other insurance companies. I recommend that you change this tax on insurance companies to a tax on life insurance companies by simply going through and putting before the words "insurance companies" the word "life."

Senator CURTIS. When the bill was originally drawn that was the intention in the House, was it not?

Dr. ADAMS. Yes.

Senator CURTIS. I wanted to bring that out.

Dr. ADAMS. As it is, it is not fair, and it is not suited to the situation. It is destructive of revenue if applied to other companies.

My proposal is that this plan of insurance taxation be applied only to life insurance companies, that it be made applicable to the income for 1921, and that it take the place of the income tax, the excess-profits tax, and the capital-stock taxes due in 1922—not the capital-stock tax due July 1, 1921, and probably paid—and that it be in lieu of the special tax on new business imposed by Title V. Also that other companies be dealt with on the basis of the present law relating to the income tax. The other companies wanted to get under this law in order to get out from under the special tax imposed on premiums. I think there will be no objection if you will abolish for the other companies the special taxes under Title V. But it would be a mistake to deal with life insurance companies and other companies under the same plan. I think you had better set out life insurance companies by themselves.

That is the plan proposed. I think in the case of life companies it is suitable from every standpoint and a wise plan, because they will really pay more under this plan than under the other taxes. It is a revenue gainer from the

life insurance companies at 15 per cent. I was somewhat doubtful when the House decided to abolish the special taxes on other insurance companies. I wondered if life insurance companies would want to back out of the plan agreed upon. But they say that with the simplicity and the advantages to be gained by this method they are willing to go on with it even though they pay more taxes.

With respect to the other companies, the real question of importance to them is whether the premium tax shall stay.

Senator CURTIS. What does that amount to, Dr. Adams?

Dr. ADAMS. We got last year between $19,000,000 and $20,000,000 from the taxes imposed by Title V. There will probably be less this year, because the amount of business will not be so great. I do not know how much of that comes from life insurance. I should say offhand that the other companies paid approximately $15,000,000. I do not want to apply this plan to other insurance companies, because the deductions are not justified in the case of other companies, because it would reduce revenue, and besides some of the phraseology is not applicable.

Senator MCLEAN. Do you say that this will be satisfactory?

Dr. ADAMS. I think so. If you put the other companies back on the present income-tax law and abolish the special tax as of January 1, 1922, it will be satisfactory. The income tax on the other companies needs to be improved, however.

Senator REED. How does that leave these mutual companies?

Dr. ADAMS. The mutual companies, outside of the mutual life companies, pay little or no income taxes.

Senator REED. This would leave them in what position?

Dr. ADAMS. It would leave them practically exempt.

Senator REED. By the term "mutual companies" I mean interinsurance companies.

Dr. ADAMS. I can not tell you about interinsurance. I think I would have heard if they were suffering under the present law.

Senator REED. The kind of insurance I have in mind is where a number of business concerns mutually insure each other.

Senator CURTIS. Isn't that what you call interstate insurance?

Senator REED. They are interinsurance companies.

Dr. ADAMS. My suggestion is that, first of all, you decide whether this plan shall apply to life insurance companies on the basis suggested.

Senator CURTIS. I move that the plan suggested by Dr. Adams be adopted, in that the provision be made to apply to life insurance companies.

The CHAIRMAN. If there is no objection, it will be agreed to.

Senator MCCUMBER. Dr. Adams, you have undoubtedly read the letter from Senator Sherman, have you not? Will you consider it for a moment?

Dr. ADAMS. That has not reached me.

Senator MCCUMBER. He wrote to the chairman, and also gave me a copy of the letter which he sent to the chairman. This is what he says:

"I have to-day written Chairman Penrose, of your committee, a letter on amending paragraph 12, Schedule A, Title II, stamp taxes, of the act of February 24, 1919, by adding after the word 'cases' the following:

"'Any organization doing business on the interinsurance or reciprocal insurance plan, through an attorney in fact, shall not be taxed on the powers of attorney contained in the applications of those who became members or policyholders in such organization.'

"This form of mutual insurance is authorized by the laws of several States. It makes the application of the person wishing mutual insurance a part of the policy subsequently issued. The power of attorney is printed in the application. It is an essential part of the contract of insurance under the State statutes named. Such companies are regularly incorporated companies under those State laws.

"I believe paragraph 12 referred to was intended to cover the ordinary powers of attorney where another was made the agent or the principal in some business transaction specific in character, such as has been known for many years.

"The reciprocal insurance company is a form of mutual, which has been used but a few years and is not generally known throughout the country. I think it is bound to say that Congress did not have it in mind when the acts of 1918-1919 were passed. It imposes a very considerable burden on this form of mutual insurance which is not carried by other mutual companies.

"The insurance is to persons of moderate means, who form such mutuals in order to insure their automobiles against loss by fire, theft or against liability by accident, covering both injury to automobiles and to the person.

"I believe that it is proper to relieve this form of insurance from the burden, which runs into a large sum of money in the aggregate, so that these persons of moderate means as the average will be correspondingly relieved."

Senator McCUMBER. Have you considered that proposition at all?

Dr. ADAMS. It is the documentary stamp tax of 25 cents imposed on all powers of attorney. It is not a very important matter, certainly not from the standpoint of revenue. I gather from what the Senator says, that powers of attorney have to be used very frequently in this business, which we have held to be mutual insurance. Possibly it will do no harm to let it go to conference.

Senator McCUMBER. I suppose that it will be best for me to leave that letter with you. As you say, it may not be important from the standpoint of revenue. However, it may do an injustice in some of these cases. If you see fit to insert something to meet this objection, perhaps we can authorize you to do it.

The CHAIRMAN. If there is no objection, it will be referred to Dr. Adams.

Senator SUTHERLAND. With power to insert such a provision.

Senator McLEAN. I called your attention to a matter of rebate pleadings and extension of time in which claims could be made so as to be in line with extensions granted with respect to estate taxes where they fail to file claim for rebate. As the law reads now, after two years they are shut out. We extended that time with respect to estate taxes to three years. I gave you a letter with respect to that matter the other day.

Dr. ADAMS. I do not remember it, Senator. I thought that I went over all my letters carefully.

Senator McLEAN. I have a letter which explains this.

Then there is another matter. You know that we adopted a provision the other day whereby a stockholder in a bank could take advantage of the stock tax which was paid by the bank.

Dr. ADAMS. You voted it.

Senator McLEAN. Why shouldn't that apply to stockholders in insurance companies? They seem to think so.

Dr. ADAMS. You mean just what?

Senator McLEAN. The tax is paid in just the same way in our State.

Dr. ADAMS. I may say to you, Senator, that I am opposed to that whole thing in principle. I do not think it is right. If one person pays a tax for and on behalf of another voluntarily, I do not think he should be given a deduction.

Senator McLEAN. Whatever the merits of the proposition may be, we did concede it to the banks. I can not see any distinction between banks and insurance companies.

Dr. ADAMS. I believe that the phraseology of the amendment is general. The deduction is given to any corporation which pays such taxes, not to banks eo nomine.

Senator McLEAN. I did not understand that it covered insurance companies. If it did, it is all right.

I would like for you to read that letter, Dr. Adams, with reference to rebates on premiums or tax on premiums. Under the old law they were permitted within two years to file a claim for a rebate where they had overpaid, and we extended that period to three.

Dr. ADAMS. I think it should be looked into.

Senator McLEAN. It seems to me that it ought to be a simple matter.

Dr. ADAMS. It is a simple matter to adopt in principle, but not entirely simple to draft properly.

Senator McLEAN. We extended the time as to the estates tax from two to three years. It seems to me that the general principle should apply as well to the income tax.

Dr. ADAMS. If you want to vote to adopt that as a general principle, I will undertake to work the amendment out.

Senator McLEAN. Don't you think the same principle should apply?

Dr. ADAMS. I am inclined to think you are right. It is, however, a matter to be looked into as to details.

Senator McLEAN. I would like to have the expression of the committee on it. I am perfectly willing to condition it upon the acquiescence of Dr. Adams. If he does not think it is right, well and good, but it seems to me that the

same principle should be made to apply to all the taxpayers. I would like to have an expression of the committee.

Dr. ADAMS. Put it this way. I think it is fair, so far as I can see to the contrary. If you want to pass that, leaving the right to me to bring it up before you if I see some kinks that I do not appreciate now, I shall be glad to take care of it.

The CHAIRMAN. With that understanding, the matter will be left to Dr. Adams.

Dr. ADAMS. You have now a large part, a very large part, of the insurance problem still left. The insurance companies now are subject to the income tax, the excess-profits tax, the capital-stock tax, and the premium tax. The latter is the 1 per cent premium tax imposed by Title V. The principal thing that these companies are interested in now is whether the premium taxes are to continue or not. That is a question of policy.

Senator CURTIS. I understood you to say it would affect the revenue to the extent of about $15,000,000?

Dr. ADAMS. That is near enough for practical purposes. That is fire and all insurance companies, except life insurance companies.

The CHAIRMAN. What is next?

Dr. ADAMS. That is the question: Whether you will abolish as of January 1, 1922, these special taxes imposed by Title V, or cut them in half, or leave them in as they are?

Senator CALDER. Just what is that?

Senator DILLINGHAM. The great objection of the outside companies is to the premium tax?

Dr. ADAMS. Yes.

Senator DILLINGHAM. I have telegrams from all over my State saying that they deem that an injustice.

Senator REED. Why should they pay a regular tax and a premium tax when the same is not required of a man in the steel business, for instance?

Dr. ADAMS. I think their request for exemption is sound.

Senator DILLINGHAM. In order that we may close the discussion, Mr. Chairman, I move that that class of companies be relieved of the premium tax as of January 1, 1922.

The CHAIRMAN. If there is no objection, the motion will be agreed to.

Senator SUTHERLAND. How much revenue do we cut off?

Dr. ADAMS. $15,000,000 or $16,000,000 a year, half of which would affect this fiscal year.

Senator MCLEAN. It does not apply to 1922?

Dr. ADAMS. The taxes stay on for life insurance companies and everybody else until December 31, 1921.

Senator SMOOT. It loses us $7,500,000; that is, half for this year and half for next.

Senator LA FOLLETTE. That is what the House did, is it not?

Dr. ADAMS. In substance.

Senator LA FOLLETTE. That applies to everything?

Dr. ADAMS. To everything. The stamp question comes up later. I take it that you want to abolish that tax, too.

Senator SMOOT. Then let us settle it now.

Dr. ADAMS. You have now the stamp tax on surety bonds and policies of guaranty insurance. It is 50 cents on each bond or policy, but where a premium is charged it is 1 per cent on the premium. On the fidelity and guaranty insurance companies this stamp tax on premiums takes the place of the premium tax imposed by Title V. I suggest that you wipe out this whole subdivision of the documentary stamp tax.

Senator CURTIS. How much revenue will that lose?

Dr. ADAMS. I can not think that it would be great. It is a tax of 50 cents applicable to surety bonds.

Senator MCCUMBER. On transfers, sales, and so on?

Dr. ADAMS. No; it is on the document or the instrument by which a bond is given for surety. There is a charge of 50 cents. The House amendment bears rather hard on small employees like the postal officials, who have to renew their bonds very frequently. It occurs on page 256, line 12.

Senator SUTHERLAND. How much revenue will be affected?

Dr. ADAMS. It can not be very much money. It may be $250,000 a year. I doubt whether anybody knows the figures.

Senator WATSON. You want to eliminate section 2?

Dr. ADAMS. It is on page 256, and reads:

"2. Bonds, indemnity, and surety. On all bonds executed for indemnifying any person who shall have become bound or engaged as surety, and on all bonds executed for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and on all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortage guaranty policies," etc.

I think that ought to come out.

Down a little further is the proviso which the House struck out.

"That where a premium is charged for the issuance, execution, renewal, or continuance of such bond the tax shall be 1 cent on each dollar or fractional part thereof of the premium charged."

That was really an insurance tax, corresponding to the premium taxes imposed by Title V, but placed here at the request of the fidelity insurance companies. I know that ought to come out if you abolish the other premium taxes.

Senator SUTHERLAND. Is that all we get out of it—$200,000?

Dr. ADAMS. I can not tell you exactly. Hardly more than that.

Senator REED. You have the stamp tax.

Dr. ADAMS. That is not graduated according to price or amount. You can get some notion of the revenue in this way. One hundred thousand documents of this kind in a year would yield $50,000; 500,000 of these documents would yield $250,000. Where a premium is paid the tax is less. The question is, do you have that many documents?

Senator SMOOT. I would say that we do.

Senator MCCUMBER. It is not a heavy tax anyhow.

Dr. ADAMS. I do not care about it.

Senator SMOOT. This was threshed out very thoroughly before. The question came up and the postal clerks were represented at the time.

Dr. ADAMS. The postal clerks are protesting at this time.

Senator SMOOT. The main company is at Baltimore, Md. We changed that to suit them at the time. This was put in to suit them.

Dr. ADAMS. That was insurance. They asked that for convenience it be paid under the stamp tax. You have stricken that out. The big fellow is bonded and pays a premium every year. He is relieved now. Do you want still to say that the little fellow shall continue to pay?

The CHAIRMAN. I do not see why we should stir it up.

Dr. ADAMS. Very well.

The CHAIRMAN. If there is no objection, the matter will stand as it is.

Senator SMOOT. I would let the whole section stand. That is the way they wanted it.

Dr. ADAMS. That was because there was a 1 per cent tax on premiums. They said that it was convenient to them to have it paid in stamp form. They said, "Leave the tax on us, but put us over in the stamp title." I think the reason that they asked that was that it is easier when paid in the form of a stamp tax.

Senator SMOOT. This matter was brought to our attention by the company in Baltimore, one of the largest in the United States. It was referred to a subcommittee, and this provision in the existing law was prepared to take care of such cases as you refer to. The post office employees were mentioned.

Senator SUTHERLAND. Can the tax be put upon the companies?

Dr. ADAMS. The point is, having taken a similar tax off of some companies, do you want to leave it on these people? This is in lieu of the 1 per cent premium tax.

Senator SUTHERLAND. It is much less than that, is it not?

Senator SMOOT. I move that we disagree to the House provision.

The CHAIRMAN. It is moved and seconded that the Senate committee disagree to the House provision, beginning at line 23, page 256. That restores the paragraph to existing law.

It is agreed to.

Dr. ADAMS. My suggestions from here on relate to things which are not income-tax matters. Mr. Beaman has requested that we clear up the income tax, so that we could get that part to the printer.

You have got your biggest question to decide, and that is the question of the surtax rates.

The CHAIRMAN. I am informed that Mr. McCoy is ready. Suppose we put him on the stand. The committee will now proceed to consider the surtax rates suggested by Mr. McCoy.

Mr. McCOY. I call your particular attention to the last column of this table. There are a number of suggested rates in the table, but I believe that the last column contains the best.

The problem which was put to me was to reduce the tax on the lower income-tax brackets, retaining the maximum of 32 per cent, not to increase the tax on any taxpayer, and not to reduce the revenue. In order to do that I began the reduction in rates at the lowest bracket of the Fordney bill.

I wish you would consider the suggestion headed (1). As I say, I began at the lowest bracket and reduced the income-tax rate—1 per cent on the bracket from $5,000 to $6,000, 1 per cent from $6,000 to $8,000, 1 per cent on each bracket up to $20,000.

In order not to reduce the revenue, I there began to increase the rate over the present law and the House bill 1 per cent on all the brackets from $20,000 all the way up to $34,000. All these rates are increased. The rates on the brackets below that are decreased. Therefore, it does not mean that people falling in these brackets will pay more tax; in fact, they will pay less tax. All the way up to incomes of $34,000 will pay less tax than under the present law, although the rates are increased on the brackets from $20,000 up to $34,000. They are decreased from $5,000 to $20,000. The reason that decreasing one bracket and increasing another does not equalize is that in the lower brackets there are so many more taxpayers than in the higher brackets. As incomes go up the number of taxpayers decrease very rapidly.

Under the provision of the rates given in the last line there are no taxpayers who would pay more tax than under the present law. Still there is a reduction on all incomes—very slight—only $10, however, on incomes in excess of $34,000 a year. They would pay less than under the present law, but, of course, the payments of the smaller taxpayers would be reduced more than the higher taxpayers. There is no decrease on the smaller taxpayer contained in the surtax rates of the House bill; there is a decrease in the committee proposal.

Senator McCUMBER. You start at $20,000. That is where you get your first increase?

Mr. McCOY. Yes. I run up, then, to incomes of $34,000. Then from there on it is the same as the present rate until the amount reaches 32 per cent, where it stops.

Senatro McCUMBER. It does not seem to me to be as good as the old one. You started at $5,000.

Mr. McCOY. Yes; with the reduction of rates.

Senator McCUMBER. I believe that the other is better than this.

Senator SMOOT. You start at $6,000.

Mr. McCOY. The entire rate, 1 per cent, is cut from the $5,000 to $6,000 bracket.

Senator McCUMBER. He was considering column I.

Mr. McCOY. These suggested rates reduce the revenue about $15,000,000, while the rates suggested in column A reduce it $30,000,000.

Senator SMOOT. With the exemptions given of course all incomes will be reduced, and that is carried on clear through, or is it only as to children?

Mr. WALKER. The additional $500 exemption applies only to incomes under $5,000.

Mr. McCOY. The exemption for children would cover everybody.

Senator CURTIS. Why is not H a better proposition?

Mr. McCOY. You can see that there I had to, you may say, juggle the rates. I decrease rates on incomes from $5,000 to $14,000. Then I immediately began to decrease and increase them alternately. You do not lose quite as much revenue. It might stimulate incomes to such an extent that there would not be any loss.

Senator SMOOT. You jump from 12 to 15?

Mr. McCOY. Yes.

Senator SMOOT. Between 28 and 32?

Mr. McCOY. Yes; but still no one pays more tax. The man at 32 will pay less tax than he does under the House bill.

Senator SUTHERLAND. The reduction is in the lower brackets?

Mr. McCOY. In the lower brackets; yes. You see, it is almost an impossible task to reduce the lower income tax brackets and not decrease the revenue. This shows practically no decrease in the revenue, but it helps those up to $30,000.

Senator McCUMBER. It helps those up to $18,000.

Mr. McCOY. Yes; but the decrease in the lower brackets will help those all the way up.

Senator DILLINGHAM. Which bracket commends itself to you?

Mr. McCOY. The best suggestion, especially as to simplicity, is (i). Of course, (h) is a good suggestion, but it is more complicated. I think, so far as revenue losses are concerned, there is not much choice between the two.

Senator McLEAN. I understand that it would not surprise you if this change raised as much revenue.

Mr. McCOY. It probably would. You will remember the House bill cut all income taxes above $60,000 but did not cut any of the lower brackets. The idea of the Finance Committee was to cut some of the lower brackets to compensate for that.

The CHAIRMAN. Dr. Adams, have you examined this proposition?

Dr. ADAMS. Senator, in this respect Mr. McCoy is able to advise you so much better than I could that I have no opinion as to the details. I am, however, interested in the result as a whole. I am wondering why the rates on incomes from $5,000 to $10,000 are considered high. I do not think personally that they are too high. I do not think, for instance, that I, who fall in those brackets, am paying too much tax. I have no doubt, with respect to the logic of the situation, that anything Mr. McCoy tells you is better than what I might suggest. I do not believe, however, that persons who have incomes running from $5,000 to $20,000 are paying too much tax. The political aspects of the question are with Mr. McCoy's proposal. Our rates, as compared with the rates of other countries all over the world, are low; that is to say, with respect to income of from five to fifteen or twenty thousand. The English rates are two, three, or four times as high as ours, and so they are in France and other places, as to the lower brackets.

Senator CURTIS. They are lower in the higher brackets.

Dr. ADAMS. Yes. There is a feeling that if you make a change for the big man you ought to make a change for the moderate-sized man. That assumes that the present basis is correct. But suppose the rates on the moderately well to do have been relatively too low in the past. That is the question. Do you want to reduce in general income-tax rates, say, from $25,000 down to $5,000?

Senator SMOOT. Don't you think that a man who has an income of $6,000 a year should pay $10 tax?

Dr. ADAMS. Oh, he pays more than that.

Senator SMOOT. I did not mean the normal tax.

Mr. McCOY. My original suggestion to the Secretary of the Treasury was to increase the taxes from $5,000 to $25,000. The taxes under the present law are not heavy—in fact, are very light—and it would be a good way to get the revenue. But that would increase the taxes on the lower incomes and decrease it on the higher ones.

Dr. ADAMS. I do not think you can increase it. Mr. McCoy was carrying out your suggestion. Is it not advisable to let them stay as they are? That is my sole point.

Senator McCUMBER. I think it will relieve the taxpayer but very little individually. I doubt if it is a good proposition.

Senator CURTIS. For the purpose of getting action I am going to move that we adopt "(i)." That is the last column.

The CHAIRMAN. Is the committee ready to vote on Senator Curtis's motion?

(After a vote.)

The CHAIRMAN. It is agreed to.

Senator REED. I want the record to show that I voted against this.

Senator SIMMONS. Mr. Chairman, I was out and did not hear the statement and do not understand it at all. I could not vote because I was not here and did not understand it. I was called out necessarily.

The CHAIRMAN. Mr. Walker desires to make a statement. I sent him out to see some people the other day, and he has this report to make.

Mr. WALKER. On page 71, line 18, the building and loan associations want the word "exclusively" changed to "primarily." They tell me that practically all the building and loan associations have some slight investments in Government bonds and the like, on which they will get a little interest. They are afraid that the Treasury Department might construe "exclusively" so as to

take them out of the exempt class. I have talked it over with Dr. Adams and he sees no harm in the change.

Senator CURTIS. I move that it be adopted.

Senator REED. Just a minute. "Primarily" means just what? Let us see what it means. (Reading:) "Domestic building and loan associations operated exclusively," and so on. They want it to read: "Domestic building and loan associations operated primarily for the purpose of making loans to members." If you change "exclusively" to "primarily," it seems to me that would make it possible for building and loan associations to contend that if it was the original purpose to make loans they could make all sorts of investments and claim exemption on a large part of their business.

Senator MCCUMBER. I think "primarily" is not a good word. It would then read "operated primarily." That is a strange word. It is not a word that anybody would adopt. It means "principally," if anything, rather than primarily.

Senator SMOOT. We are going a long way to put this in here at all. Domestic building and loan associations are really for the purpose of lending money for the building of houses. A lot of them are not doing that, but are lending money to members of their association. They are lending it right straight out, just as other institutions are lending money. I do not even like this, "for the purpose of making loans to members." Of course, if you are going to say "primarily," they can go into any business.

Dr. ADAMS. It is a privilege that is abused. I think your feeling is right. The House, upon my calling attention to the fact, really went much further than they meant to go. The use of the word "exclusively" would practically deny the privilege to all building and loan associations. If you can get an intermediate word, I should think it would be wise to do so. This was done by the House committee. I think "exclusively" is going to prove more drastic than you expect, and it will cut out a number of legitimate, ordinary, and regular building and loan associations. I agree with Senator Smoot that this thing has been abused.

(After informal discussion.)

Senator MCCUMBER. Why not make an exception where there are nontaxable bonds and say that they shall not be considered as part of their income.

Dr. ADAMS. They are likely to acquire incidentally a stray security or two. This building and loan association privilege in a few cases has been abused, as Senator Smoot says. Practical investment companies are getting out under it. On the other hand, the building and loan association—the bona fide, real building and loan association—frequently has a few incidental securities. Can we not get the proper word in there?

Senator SMOOT. Suppose it is tax exempt?

Dr. ADAMS. Suppose they get a railroad bond or something of that kind?

(After informal discussion.)

Dr. ADAMS. Why not use the word "principal"?

The CHAIRMAN. Do you recommend this, Senator Calder?

Senator REED. Let me suggest this.

The CHAIRMAN. Is the committee ready to vote on the proposition?

Senator REED. I want to suggest an amendment. Change it so that it will read: "Domestic building and loan associations substantially all of whose business is confined to the making of loans to members." Instead of having it read "Operated exclusively for the purpose of making loans to members," make it read "Domestic building and loan associations substantially all of whose business is confined to making loans to members." When you say "substantially all," it leaves leeway for the small loans.

The CHAIRMAN. The committee has heard the amendment suggested by Senator Reed.

Senator MCCUMBER. You could do it by percentages, if you wanted to. You could say, for instance, 80 per cent or 75 per cent.

Senator REED. Senator McCumber makes a very good suggestion. It could read: "Building and loan associations at least 90 per cent of whose business shall consist of loans"——

Senator MCCUMBER. Use "80 per cent."

Dr. ADAMS. We haven't any good measure of the business of the building and loan associations. I think that we can get along and do what we want to do under Senator Reed's amendment. That would be my opinion offhand.

The CHAIRMAN. The question is on Senator Reed's amendment. If there is no objection, it will be agreed to.

Senator SMOOT. The other day I gave Dr. Adams a letter from Mr. Reed, of New York. That part of the letter which I handed to him has been taken care of, I understand. There is another question that Mr. Reed calls my attention to. It has to do with page 35, lines 15 and 16. That matter went over while we were cleaning up some other business. I think that we had better clear this up at this time. Mr. Reed says: "Supplementing my letter of yesterday, there is one further phase of the revenue bill which I wish particularly to call to your attention. It is the proposed elimination of the clause in parentheses in paragraph 2 of subdivision (a) of section 214 (also section 234) reading as follows. '(other than obligations of the United States issued after September 24, 1917.)' The effect of this amendment, retroactive for 1921, would approximate 1 per cent interest loss to original Liberty bond subscribers who are now paying 6 per cent and receiving of course only 4¼ per cent on their bonds. At the present time, the interest paid on the Liberty bond loans can be deducted from gross income and this advantage has made it possible for many subscribers to carry their bonds up to the present time.

"It may be that they should be forced to sell at this time, but even so they should not lose the benefit of the deduction which they have relied upon in carrying their bonds through the present year. This would be a very severe hardship, involving a relatively large amount of money to men who can least afford to lose it.

"While I believe the present provision should be retained, you might wish to consider inserting after the figures '1917' the words 'in the hands of the original subscriber or a member of his family, including such obligations acquired in exchange for or concurrently with the sale of other such obligations.'"

Dr. ADAMS. Couldn't that be taken care of by making the change to January 1, 1922, which might appropriately be done?

Senator SMOOT. That is, disagree to the House amendment?

Dr. ADAMS. Make this one effective January 1, 1922, for the future. You deny this year, but you do not penalize for this year. Make effective this amendment to subdivision 2 as of January 1, 1922.

Senator SMOOT. By disagreeing to the House amendment and putting that provision in?

Dr. ADAMS (after informal discussion). This relates only to tax-free bonds. It is a question of interest on money borrowed to carry them.

The CHAIRMAN. Is the committee ready to vote? If there is no objection, the matter submitted by Senator Smoot will be embodied in the bill, the phraseology having been fixed by Dr. Adams.

Dr. ADAMS. This amendment is to take effect January 1, 1922.

Senator CALDER. Will that affect the value of the bond?

Dr. ADAMS. It might affect it a little now.

The CHAIRMAN. What is next, Dr. Adams?

Dr. ADAMS. I have an important suggestion on page 13, sir, at line 3. It relates to the question of reorganization, and is a very vital and a very important one. This is an exempt on phrase. It reads:

"When in the organization or the reorganization of one or more corporations a person receives in place of any such property owned by him new stock or securities. The word 'reorganization,' as used in this paragraph includes a merger, consolidation (however effected), recapitalization, or a mere change in identity, form, or place of organization of a corporation."

There is some doubt in the minds of the lawyers who deal with this subject as to whether the language which I am going to read would not be better. Insert, after the words "however effected" the words "including the acquisition by one corporation of the capital stock or properties of another corporation."

In other words, this is an integral part of many of the reorganizations and consolidations that are effected.

Senator SMOOT. You will remember, Dr. Adams, that the words "however effected" have been shifted.

Dr. ADAMS. Yes. This should come after the word "consolidation," and it would read, "including acquisition by one corporation of the capital stock or properties of another corporation." I see no reason why it should not be so stated.

They also wanted a change—it seems advisable—in line 5. Change the word "and" to the word "or."

From a grammatical point of view, that shift should go after "recapitalization."

Senator McCUMBER. What is that line?

Dr. ADAMS. Line 4, page 13—"however effected." You authorize me to shift it to another point.

This means that if there are two or three corporations and they reorganize, and the stockholders, having certain securities, get new securities, they will not be taxed.

Senator SMOOT (after informal discussion). If that is agreed to, I move to take a recess.

Senator REED. My vote is against that proposition as it now stands.

The CHAIRMAN. I would like to ask Dr. Adams and the committee to refer to page 12.

Dr. ADAMS. With respect to that, it is understood that the words "for investment" go out.

The CHAIRMAN. It goes out and the paragraph goes back in the bill.

If there is not objection, that will be done.

Dr. Adams, you have some 20 or 30 further amendments to submit, have you not?

Dr. ADAMS. Yes.

The CHAIRMAN. They are important, are they?

Dr. ADAMS. Three or four of them are. Most of them are reasonably important or I would not bring them in.

The CHAIRMAN. How much time will you require, in all probability, or will the committee require to consider what you have remaining?

Dr. ADAMS. Fifteen of the 20 amendments can be disposed of in about 20 minutes. Some of the others will require discussion, if you want them.

The CHAIRMAN. You will require a couple of hours this afternoon in all probability?

Dr. ADAMS. Yes.

(Informal discussion followed.)

The CHAIRMAN. The committee will stand adjourned until 3 o'clock this afternoon.

(Thereupon, at 1.30 o'clock p. m., a recess was taken until 3 o'clock p. m. of the same day.)

AFTER RECESS.

The committee reconvened at the expiration of the recess, Hon. Reed Smoot presiding.

Senator SMOOT. The committee will come to order. Mr. McCoy, you were asked to report with reference to luxury taxes, with suggestions you have to make as to the items of the present law eliminated by the House which, in your judgment, you think ought to be inserted in the present bill, together with the rates that you suggest.

(Mr. McCoy submitted to the committee the following statement, headed "Luxury tax.")

LUXURY TAX.

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.
Umbrellas and parasols, in excess of $5 each.
Fans, in excess of $1 each.
House coats or jackets, smoking coats, and bath robes, on entire cost.
Waistcoats, fancy, sold separately, on entire cost.
Hats and bonnets, women's, in excess of $10 each.
Hats and caps, men's, in excess of $5 each.
Boots, shoes, pumps, and slippers, in excess of $5 per pair.
Men's and Boys' neckwear, in excess of $1.50 each.
Silk stockings and hose, on entire cost.
Men's silk shirts, on entire cost.
Silk underwear, pajamas, nightgowns, kimonos, and petticoats, on entire cost.
Waists, women's and misses', in excess over $6 each.
Additional luxuries that may be taxed:

All furniture and office fittings, not elsewhere taxed in this title, of mahogany, rosewood, or other imported cabinet woods, on entire cost.
Evening clothes or dress, on entire cost.
Cloth of all kinds, including imitation furs, on excess over $5 per square yard.
Laces, embroideries, etc., on entire cost.
Photographic apparatus and accessories, other than cameras and lenses.
Billiard and pool tables.
Limited art editions of books.
Liveries.

Mr. McCoy. In the first place, this section 904, page 221, line 14, you gentlemen are familiar with the history of.

(Senator McCumber took the chair.)

Mr. McCoy. This section 904 of the present law came over from the House when they were framing the 1918 revenue law. As soon as it got to the Senate it was stricken out of the bill without any attempt to perfect it whatever. When it got to conference the House insisted on the section going back into the bill. Then there was no choice. It either had to go back in the bill as it left the House, without any perfection, or be stricken out. The House insisted on its going back.

The difficulty was that, although it was a tax that would apply only to luxuries, the Government was not able to enforce it.

These articles are sold in stores where hundreds of other articles are sold; and to show the difficulty with the enforcement I will just take one example, that of an umbrella. A person would go into a store and buy an umbrella. If he had to pay $5 for the umbrella he would be taxed on the excess over $4. He might make several purchases at that store. The storekeeper could put the price of the $5 umbrella down to any rate he wanted, and he could put the price of other things up to any rate he wanted. You can not prevent a man's losing on some goods and making on others.

As a result of this, whereas we should have collected some eighty millions of dollars, it amounts to twenty millions of dollars.

The House has stricken it out with the exception of a few of the items therein, but instead of making it a tax payable on the retail sale it is a tax on the manufactured price.

Senator CALDER. Did the House do that?

Mr. McCoy. The House did that. The House amendment is on page 218, beginning with line 9.

Senator WATSON. Does anybody know how they happened to take these articles rather than any others?

Mr. McCoy. Yes, sir; I can tell you that. The other articles were first stricken out. They were principally articles of clothing, especially ladies' clothing; and Mr. Longworth was instrumental, I think, in having them stricken out. Then, as a final amendment, they were all stricken out, but before it left the committee they were put back with the manufacturer's tax, as to these eight items, instead of a tax on the retail item.

The problem was put up to me to find the price of these articles. I got a Sears, Roebuck & Co.'s catalogue and went through it, and I have the prices of all the articles, minimum and maximum, in that catalogue, and the prices which I have put opposite these things on this typewritten statement are practically Sears, Roebuck & Co.'s maximum retail prices. I have the catalogue here. On any item I can show you the illustrations and prices.

Senator DILLINGHAM. These are their maximum retail prices?

Mr. McCoy. Yes, sir; any they are supposed to be wholesale prices. The tax is on the manufactured price as sold by the manufacturer.

Senator REED. You mean that Sears, Roebuck & Co. sell at wholesale prices?

Mr. McCoy. They do in some cases. I can buy some things here in Washington cheaper.

Senator REED. Then these prices do not give us the wholesale figure.

Mr. McCoy. No, sir; it is practically impossible.

(After informal discussion.)

Senator WATSON. How much revenue do we get from these items?

Mr. McCoy. From twenty-five to thirty millions of dollars.

Senator MCCUMBER. From everything, including furs?

Mr. McCoy. No; just the luxury taxes.

Senator MCCUMBER. You mean, starting with carpets and going down to waists, on this statement?

Mr. McCoy. Yes, sir.

Senator Gerry. What does it raise now?

Mr. McCoy. Under the present law we are getting about $20,000,000; but it is a retailer's tax and could be easily evaded.

Senator Gerry. What will this raise?

Mr. McCoy. Twenty-five millions as a minimum. It is a manufacturer's tax.

(After informal discussion.)

Senator Reed. Has anybody thought of the propriety of taxing hotels on their room charges or in accordance with their room charges?

(After informal discussion.)

Senator Reed. I make the motion that we ask Mr. McCoy to draft an amendment levying a tax upon hotel room charges.

Senator McCumber. Some distinction will have to be made as to hotels open only a few months of the year and those open all the year round.

Senator Smoot. At what rate? Over and above $5?

Senator Reed. Yes. Let Mr. McCoy work it out on a practical plan and let us get started.

Senator Smoot. Then he will present it to us when he gets it ready.

Senator Curtis. Let us take that and cut out the tax on clothing.

Senator Smoot. What do we want to do with regard to carpets? Mr. McCoy has it $4 per square yard instead of $3.60.

Senator Reed. Is that levied on the manufacturer's price?

Mr. McCoy. Yes, sir. By the time it gets to the retailer it is in many cases twice that.

Senator La Follette. What is the retail price of rugs at $4 per square yard?

Mr. McCoy. The most expensive rug that Sears, Roebuck & Co. sells is $3.85—the Wilton velvet carpet—and the cheapest is $1.49.

Senator Simmons. Mr. McCoy, about what would a carpet sold by Sears, Roebuck & Co. at $4 per square yard sell for at wholesale?

Mr. McCoy. Of the carpets sold by Sears, Roebuck & Co. the most expensive one is $3.85. They would pay the manufacturer about $3 a yard for that carpet.

Senator McCumber. The ordinary retail price is practically double?

Mr. McCoy. Yes, sir.

(After informal discussion.)

Senator Simmons. If you fix the basing point at $4 per yard, that would exempt from taxation all the lower grades of carpets.

Senator Smoot. I think $3.60 will.

Senator Curtis. Let us make it $4; rugs, $6; trunks, $35.

Mr. McCoy. The best trunk that Sears, Roebuck & Co. sells is $32.

Senator Smoot. That is retail. The House has it at $30, and I think that is enough.

Senator Curtis. Let us make trunks $30.

Senator Smoot. Yes; I think it ought to be that. That is the way the House has it.

Senator Curtis. Let us put the valises at $15.

Senator McCumber. If there is no objection, it is so ordered.

(After informal discussion.)

Senator Calder. I move to strike out purses, pocketbooks, shopping and hand bags.

(The question on Senator Calder's motion was put and lost.)

Senator La Follette. I move to adopt the list and the rates as presented by Mr. McCoy.

Mr. McCoy. The rates are 5 per cent on the excess.

(After informal discussion.)

Senator Reed. I move to strike out from the item commencing with "housecoats" the words "and bathrobes."

(The question on the motion of Senator Reed was put and carried.)

Senator Calder. Let us consider striking out all items of wearing apparel.

Senator McCumber. The Senator from New York moves to strike out all articles of wearing apparel.

(The motion was carried.)

Senator McCumber. We are putting in new taxes, gentlemen. Do you want to do that? If there is no objection, I shall put the question as to whether we shall include any of these which are new articles of taxation.

(The motion was put and lost.)

Senator McCumber (after informal discussion). The question now is whether we shall include furniture and office fittings in the first subdivision.

Senator SIMMONS. It should be all office furniture and fittings. Is that what you meant, Mr. McCoy?

Mr. McCOY. All manufactures of mahogany. Of course, you can limit it as much as you wish. Pianos are taxed elsewhere, and I did not want to tax them here.

Senator REED. Let us say "office furniture and office fittings."

Senator MCCUMBER. Do you vote to retain it?

Senator REED. I am suggesting that, and then we can vote on whether we shall retain it or not.

Senator MCCUMBER (after informal discussion). The first question is, Shall we agree to the proposed amendment by adding the word "office," so that it will refer to office furniture?

(Agreed to.)

Senator MCCUMBER. It now applies only to office furniture. Now the question is, Shall we accept it as modified?

(Agreed to.)

Senator REED. I understand that all articles of dress are out?

Senator MCCUMBER. Yes.

Senator REED. Would laces go out with the clothing?

Senator MCCUMBER. Anything that is worn, I suppose.

Senator REED. Laces are used on tablecloths and pillows and bed covers, etc.

Senator CURTIS. Leave it out if you are going to leave out clothing.

Senator MCCUMBER. I will now put the question on clothing of all kinds, including imitation furs.

Senator SMOOT. Imitation furs are clothing.

Senator MCCUMBER. It will be understood as being out.

Laces, embroideries, etc. I do not think that means clothing?

Senator REED. I think you had better let them go with the clothing.

Senator MCCUMBER. I think so. Unless there is objection it is so ordered.

Photographic apparatus and accessories other than cameras and lenses.

Mr. McCOY. You have taxed cameras and lenses already.

Senator MCCUMBER. If there is no objection, they will be included.

Senator DILLINGHAM. What is the idea of putting a tax on photographic apparatus outside of cameras?

Senator WATSON. Nothing—but to get the money.

Senator DILLINGHAM. There is only one thing in that list that I am willing to tax, and that is liveries.

Senator SMOOT. This means that you are going to tax the camera that weighs over a hundred pounds. If you put in this wording, they would be taxed.

Senator MCCUMBER. The next is billiard and pool tables.

Mr. BEAMAN. You have already taxed billiard and pool tables under the sporting-goods tax on page 216, line 4.

Senator MCCUMBER. Suppose we strike that out, then.

(Agreed to.)

Senator MCCUMBER. Now comes the question of liveries.

Senator DILLINGHAM. That is clothing.

Mr. McCOY. It is taxed in the present law at 10 per cent.

Senator CALDER. I will ask unanimous consent to return to page 218, line 5.

Senator MCCUMBER. Let us dispose of this first.

Dr. ADAMS. I want to say one thing before you go through with that, gentlemen. I have no interest in what you are doing except from an administrative standpoint.

These taxes imposed to-day are probably the most widely evaded taxes that are imposed. There are several reasons, but the strongest is that having a tax on a limited part of an article makes a commercial house keep separate accounts on particular items. It is hard enough for a man to be honest with this kind of taxation anyhow. It is almost sure to be evaded, and there is no way that the department can check it.

My sole point is that if you have any expectation of having the tax collected do not put it that way. There is no way of checking it administratively that I know of, and no way to prevent widespread evasion, if the tax is imposed that way. You can see the effect on a business concern of isolating not a particular line—they can do that—but isolating particular articles of particular lines.

Senator CALDER (after informal discussion). Are these items that we are taxing now under a manufacturer's tax?

Senator McCUMBER. Yes. Those in favor of making the tax 5 per cent on these items signify the same by raising the right hand.

(Agreed to.)

Senator CALDER. There is one item in connection with this matter that I want to call your attention to—page 218, line 5.

Senator McCUMBER. Where these are stated as in excess they are to take the place of the House provisions?

Mr. McCOY. Yes, sir.

Mr. WALKER. If you make it "if sold for more than," you do not make the manufacturer make a deduction in his separate account of the amount that you allow him to deduct in each case. I think the bookkeeping end for the manufacturer would be much simpler, if you thought proper, to follow the House policy, imposing a tax on the article if sold for more than a certain price without giving an exemption.

Senator CURTIS. Let us follow the House, then.

Senator REED. If a man goes into a store and buys a hat for $5, he does not pay any tax. If he buys a hat for $5.50, he pays a tax on $5.50?

Mr. WALKER. That is right.

Senator REED. If he pays it upon the excess over $5, then he is paying a luxury tax. I do not intend to vote to make any such irregularity as that.

Senator McCUMBER. All of these are written "in excess of."

Senator SMOOT. I would like to ask for another vote on the item on page 219, lines 1 to 5. I am quite sure that the committee did not understand this fully when they voted the other day.

Senator McCUMBER. Before we leave this let us fix it up. Mr. McCoy did not include portable light fixtures. You have made these "in excess of," the tax to apply on the excess, but in the case of the portable light fixtures, which I think he inadvertently failed to insert, it is "if sold for more than $10."

Senator SMOOT. Put them in "in excess of."

Senator McCUMBER. That is what I want permission to do.

Senator SMOOT. On page 219, lines 1 to 5, the House struck out these words:

"If any manufacturer, producer, or importer of any of the articles enumerated in this section customarily sells such articles, both at wholesale and at retail, the tax in the case of any article sold by him at retail shall be computed on the price for which like articles are sold by him at wholesale."

That is the existing law. It was stricken out by the House. I ask that the committee disagree to that amendment.

Senator DILLINGHAM. I second the motion.

Senator SMOOT. What do you say about that, Dr. Adams?

Dr. ADAMS. I agree very thoroughly with you, sir.

Senator McCUMBER. If there is no objection, the vote by which the House amendment was agreed to will be reconsidered.

Senator SMOOT. I move that we disagree to it.

(Motion carried.)

Senator CALDER. Mr. Chairman, I will ask for a reconsideration of the action taken on subdivision 20, on page 218, lines 5 to 7:

"Yachts and motor boats not designed for trade, fishing, or national defense, and pleasure boats and pleasure canoes if sold for more than $15, 5 per cent."

The committee passed upon that and increased it to 10 per cent. Last year the tax upon these motor boats brought in about $200,000. To-day there is not a shipyard in America that has 25 per cent of its men employed. During the war the Government took over some 400 yachts and motor boats.

Senator McCUMBER. Without objection, the motion by which the House amendment was rejected will be reconsidered, and I will put the motion again.

Those in favor of rejecting the House amendment will raise their right hand; opposed the same. The motion is lost.

Dr. ADAMS. Now, gentlemen, here is the question of the Philippine Islands. I bring you the question as one of principle, and I am asking you to let me work out the details. Gen. Wood sent this telegram to Secretary Weeks, who transmitted it to Senator Penrose:

"All nationals in the Philippines except Americans exempt from liability for the United States income tax. No foreigner here required to pay income tax to his home Government. Americans here also pay income tax Philippine Government. Financial situation very critical and heavy losses have already been sustained. Attempt collect back taxes under revenue act 1918 would be futile the majority of cases and would only result in bankrupting many of such Americans as still remain in business, leaving commercial field entirely in the

hands of British and other foreigners. We therefore urgently recommend that Americans be placed on the same tax basis here as other nationals, otherwise they are penalized for being Americans and are unable to successfully compete with those who are exempt; and that the relief granted be made retroactive to include exemption from tax liability under internal revenue act of 1918."

There are two points involved here. An American citizen or domestic corporation doing business in the Philippines under the present law is subject to our entire tax. He competes in the Philippines with the nationals of other countries subject only to the Philippine tax, which is very much less. You corrected that situation for the majority in your foreign-traders plan. Those Americans living in the Philippines with less than 20 per cent of their business in this country would pay taxes as foreigners and would not be subject to our tax. So that the problem for the great majority of these people in the future will be corrected, and that should satisfy most of the complaints from that quarter.

There are two further matters to be considered in that connection. In the first place, should any such relief given, if any is given, be made retroactive, so as to apply to the past as well as the future? Another point which is not so important, but still important, is this: Are American business men living in the Islands, who derive, say, 70 per cent of their income from outside the United States and 30 per cent from sources within the United States, to be exempt on the 70 per cent or be subject to our income tax? They would not come within the class of foreign traders.

Senator McCUMBER. That applies to the Filipinos?

Dr. ADAMS. No; that applies to American citizens. The Filipino is not subject to our tax. If you legislate for the Philippines, you should also legislate for Porto Rico. I am bringing up this matter, as Senator Penrose asked that it come up, and Mr. Hord asked me to bring it up.

Senator SMOOT. What objection do you see to the amendment as suggested the other day? It is broad:

"That in the income tax to be levied, assessed, collected, and paid in accordance with the laws enacted by the Legislature of the Philippine Islands, neither the provisions of this act nor the provisions of the revenue act of 1918 shall apply thereto, nor shall a tax be collected thereunder upon income derived by any individual or corporation from sources within the Philippine Islands."

Dr. ADAMS. If I understand it, it raises the question whether you shall exempt the American citizen living in this country from taxation upon his income derived from sources in the Philippines. That is the trouble. I don't see any more reason why he should be exempted than if he had derived his income from Denmark, France, Canada, or Alaska. It goes too far.

Senator SMOOT. If he was here he would be taxed.

Dr. ADAMS. Not under your language. You are exempting him on the basis of the income, not on the basis of the residence.

Senator McCUMBER. What is the status of the Filipino in that respect?

Dr. ADAMS. The native Filipino is not subject to our tax at all, unless he derives income from the United States.

Senator McCUMBER. Therefore the Philippine Islands, so far as this is concerned, is considered an independent country?

Dr. ADAMS. They levy their own income tax.

Senator McCUMBER. And also levy their taxes on imports, etc.?

Dr. ADAMS. Yes.

Senator McCUMBER. If that is true, and that is entirely in their own hands, why should we give them special treatment different from other foreign nationals which do the same thing?

Dr. ADAMS. The resident of the Philippine Islands is now subject to the foreign trade proposition, which exempts everybody who receives as much as 80 per cent of his income outside the United States. They seem to be asking what would be a little more convenient for them—to exempt them from income derived in the Philippine Islands.

Senator SMOOT. They want to be placed on the same footing with citizens of other foreign countries doing business in the Philippines.

Dr. ADAMS. That is a plea with which I am heartily in sympathy. That is a little different from your language.

Senator SMOOT. I suggest that you write a paragraph placing them on the same basis with other foreigners doing business in the Philippines.

Dr. ADAMS. We can't do that in those terms, because we don't know what basis the foreigner has.

Senator SMOOT. Let them pay the tax as assessed in the Philippine Islands for any American doing business in the Philippine Islands.

Dr. ADAMS. That is what you have done under your 20-80 proposition, very largely. Here is the point: Can we give an exemption to all Americans from income derived in the Philippine Islands? Suppose an American lives here for the most part and owns bonds of a Philippine railroad and gets interest on them. We don't want to exempt that, do we?

Senator SMOOT. No. All I am interested in is having the American doing business in the Philippine Islands exempted from any tax other than the Philippine tax, the same as the foreigners from other countries enjoy in the Philippine Islands.

Dr. ADAMS. Suppose he does 10 per cent of his business in the Philippine Islands and 90 per cent of his income is derived from the city of New York. Would you want to exempt him from the 10 per cent? That is the problem.

Senator SMOOT. I would exempt him from whatever business he does in the Philippine Islands.

Dr. ADAMS. You don't mean interest on bonds and that kind of thing?

Senator SMOOT. Whatever his business is in the Philippine Islands, so he can compete with the foreigners.

Dr. ADAMS. It is in terms of business you want to exempt him? That is vital. You don't mean it should apply to interest on bonds.

Senator CURTIS. Does not your amendment cover that point?

Dr. ADAMS. Take a man who is deriving 75 per cent of his income from the Philippines and 25 per cent in this country. Would you want to take care of him?

Senator CURTIS. What do you say about that?

Dr. ADAMS. I am inclined to think that unless he gets 80 per cent he ought to stay with the general class, but I have no deep feeling on it.

Senator SMOOT. Mr. Hoard has talked this matter over with you a good many times, has he not?

Dr. ADAMS. He talked with me briefly last night, and if you think it a desirable thing to give an exemption on business income derived from the Philippine Islands, we will do it.

Senator MCCUMBER. We have adopted the 80 per cent, and I think it should stay.

Dr. ADAMS. What about the retroactive feature of the income tax? That was a hard fought matter before this committee. It was discussed a long while. I thought you reached a wrong conclusion at the time, but you reached your conclusion deliberately, that an American corporation doing business in the Philippines would be subject to our taxes. For the most part, they have not paid those taxes. Some few have, but probably 90 out of 100 have not. What Gen. Wood is saying is that if you attempt to collect the back taxes you are not going to get them, or if you do get them you will bankrupt the people. Shall we put in the present law a retroactive provision exempting them from these taxes?

Senator MCCUMBER. And retain the taxes paid by those who did pay?

Dr. ADAMS. I really think if you do it you should give a rebate to those who have paid.

Senator LA FOLLETTE. What would that cost in revenue?

Dr. ADAMS. I think it would not cost very much. It is very hard to tell.

Senator MCCUMBER. Personally, I do not think we should relieve them, but should collect it if we can.

Shall we take a vote upon it?

Dr. ADAMS. First upon the retroactive question.

Senator MCCUMBER. The question is, Shall the law be made retrocative?

(The question was agreed to.)

Dr. ADAMS. Now, shall we adopt a special provision giving an exemption?

Senator MCCUMBER. Having made this retroactive, the question is, Shall we rebate to those who have paid taxes?

(The question was agreed to.)

Senator WATSON. Mr. Chairman, there was a matter Senator Simmons wanted brought up, regarding the 2 per cent tax on proprietary medicines.

Senator CURTIS. How much revenue does that bring?

Mr. MCCOY. About $3,000,000.

Senator WATSON. I have been requested by some of my constituents to bring the matter up, and I will move to strike out that provision levying a 2 per cent tax on proprietary medicines. Let us take a vote on it.

Senator McCUMBER. We will consider the previous vote reconsidered, if there are no objections.

The question is, Shall we agree to the House amendment, striking out the tax on proprietary medicines.

(The question was agreed to.)

Senator SIMMONS. Mr. Chairman, I have to leave and I do not know that I will be able to be back this evening, if you hold an evening session. I want to ask permission, if I do not return, that either Senator Reed or Senator Gerry be allowed to cast my vote on all things.

Senator McCUMBER. Very well.

Dr. ADAMS. Page 13, subdivision (f). That page relates to exchanges of property for property. It provides that in certain cases a tax shall not be imposed when his property is exchanged. It also provides in all such cases that the property you get in exchange shall take the cost basis, and so on, that was ascribable to the property you gave in exchange for the other property. It further provides in section (f), at the bottom of page 13, a very important provision:

"The basis for ascertaining allowable deductions for loss, exhaustion, wear and tear, obsolescence, amortization, and other like deductions, except those authorized in paragraph 10 of subdivision (a) of section 214 and in paragraph 9 of subdivision (a) of section 234, shall be the same basis as that provided by subdivision (a) and (b) of this section."

That means, in the case of depreciation or obsolescence, that in practically all cases the deduction must be taken on the cost basis and not on the value as of March 1, 1913. The Secretary of the Treasury would like you to make such changes as are necessary to permit the depreciation deduction to be taken on the basis of the March 1, 1913, value in cases where the property was acquired before that date. I suggest, as a method of accomplishing that, that paragraph (f), beginning with line 23, page 13, be stricken out, and that the period at the end of subdivision (e), line 22, be stricken out and a semicolon inserted, and the following words inserted:

"But the deductions authorized by paragraph 8 of subdivision (a) of section 214, paragraph 10 of subdivision (a) of section 214, paragraph 7 of subdivision (a) of section 234, paragraph 9 of subdivision (a) of section 234 shall, in case the property is acquired before March 1, 1913, be based upon the fair market price or value as of that date."

That you have already done in respect to depletion, but in respect to depreciation it has not been done.

Senator WATSON. You have already offered an amendment to that subdivision (e)?

Dr. ADAMS. Yes.

Senator WATSON. Does that amendment interfere with this amendment?

Dr. ADAMS. I have done this very hastily. What I want is the authority, if you will grant it, to make the necessary change to state explicitly that the depreciation deduction in case of property acquired March 1, 1913, may be taken on the basis of the value on that date.

Senator McCUMBER. If there are no objections, it will be agreed to.

Dr. ADAMS. On page 13 I want to ask you to make one more amendment, in line 1. That is this very important reorganization matter, and my amendment is designed to protect against a possible abuse. The abuse is this: As you know, ordinary dividends may be and sometimes are issued in the form of stock. The Pennsylvania Railroad Co. paid a big dividend one time in B. & O. stock. It provides here:

"When in the reorganization of one or more corporations a person receives, in place of any such property owned by him, new stock or securities."

That is not taxable. I want to safeguard that so if they use that to get out dividends it will not be exempted; and I suggest that on page 13, line 1, you strike out the word "new," and after the word "securities" insert the following: "of a corporation a party to or resulting from such reorganization," so that it will then read:

"When in the reorganization of one or more corporations a person receives, in place of any such property owned by him, stock or securities of a corporation a party to or resulting from such reorganization."

Senator DILLINGHAM. I move the adoption of the amendment.

Senator McCUMBER. If there are no objections, it will be agreed to.

Dr. ADAMS. I have nothing more for the time being on the income tax.

Senator McCUMBER. At this point I wish to bring up one matter, so we will not have to go back over this particular matter again. I wish you would turn to pages 101 and 107, section 250. Subdivision (d) on page 101 provides:

"The amount of tax due under any return made under this act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the commissioner within three years after the return was filed, and the amount of tax due under any return made under this act for prior fiscal years, or under prior income, excess-profits, or war-profits tax acts, shall be determined and assessed within five years after the return was filed"—

Under this act you make your assessment within three years in the one case and five in the other—

"unless both the commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceeding for the collection of any tax due under this act, or under prior income, excess-profits, or war-profits tax acts, shall be begun after the expiration of five years after the date when such return was filed, but this shall not affect suits or proceedings begun at the time of the passage of the revenue act of 1921."

In other words, after your return has been filed, the Government can have five years in which to claim that you have not paid as much tax as you should have paid. The Government may acquiesce for five long years, and after you have forgotten what your tax items are it may come back to you for additional taxes. I do not object to that, providing you give the taxpayer a reciprocal right when he has overpaid his tax. You will find that in relation to refunds, on page 107, section 252 provides:

"That if upon examination of any return of income made pursuant to this act it appears that an amount of income, war-profits, or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits, or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due."

That gives the taxpayer the same right to claim a refund within the same time that is allowed the Government to claim a deficiency in taxes. But when we come to the tax provision, which is under Title X, special taxes, page 232, we find the following:

"*Provided*, That no such credit or refund shall be allowed or made after three years from the date when the return was due unless before the expiration of such three years a claim therefor is filed by the taxpayer."

There is no provision in that title limiting the right of the Government to make the claim of lack of sufficient tax; and that being the case, I would ask the same limitation that is given the Government and is given the taxpayer in other sections should be granted the taxpayer in this instance, namely, five years. I think that should be amended on page 232, line 16, by striking out the word "three" and inserting the word "five."

Mr. BEAMAN. That has all been stricken out.

Dr. ADAMS. That was agreed upon in terms of three years this morning. With respect to all special taxes it was proposed to give a three-year period to the Government and a three-year period to the taxpayer.

Senator McCUMBER. Both ought to have the five years, one as much as the other. Why should you limit either one different from the other?

Dr. ADAMS. Both should be limited. The question is whether it should be three years. I think three years is the most wholesome. I think it is too long if anything.

Senator REED. I think you should put your statute of limitations in one clause, and say in a general clause that all actions by the Government shall be brought within so many years, and that all claims for refunds shall be brought within so many years, under all the provisions of this act.

Senator McCUMBER. All these taxes are complex. The rights of the taxpayer are sometimes rather difficult to ascertain by him. He makes out his return and pays his tax during the year. He often pays a bigger tax than he thinks he should pay, but he wants to avoid penalty and pays it. Then somebody who is willing to take the chance of a penalty refuses and brings a suit. Suits are not decided immediately, sometimes not for five years. Often his right to know depends upon the result of an action in the courts.

In California some time ago a gentleman had a dance hall, with a place for seats outside. He sold tickets to people who wanted a chair to sit down and look at the dance. He sold an additional ticket if they wanted to go inside the railing and dance. He asked the department whether he would have to pay a tax upon the ticket that he issued to the people who occupied the chairs, and they said no, it was only upon the ticket admitting to the dance itself. He made no collections, and one or two years later the department considered it had made a mistake and that he should have paid a tax on the people who took the chirs. He had never collected anything from them, and he felt it was wrong.

They settled it in some way, but these things are not all settled within one or two years, and there ought to be some way of disposing of this question.

Senator WATSON. Have you the language formulated?

Senator MCCUMBER. No. I understand this was all stricken out. All I ask is that we have the same period in every case. On page 285 there is no period mentioned, and the department has construed, from the revised statute mentioned, which was two years, that the claim would have to be made in two years.

Senator REED. It seems foolish to my mind to have in a dozen different places in this bill the limitation of the time within which claims or suits can be filed. Could not one general clause be put in the bill and made applicable to all of them?

Dr. ADAMS. I have no objections if you will give definite directions on certain points. One is the period within which the Government can revise or change assessments. Corresponding with that, on the taxpayer's side, is the period within which the taxpayer may make claim for administrative refunds. My opinion is that the limit for both should be shorter. The department should not have the right to be revising these things so long. I think the period should be three years in both cases.

Somewhat different from that is the period within which both can bring suit. I think that should be five years.

Senator MCCUMBER. It is the duty of the Government to make its assessment within three years, and it may make it within three months or one month, and when it has made it, then the Government has the five years from the time of the filing.

Dr. ADAMS. The right of the taxpayer is or should be from the time the tax was paid. I should make the time for bringing suit a little longer than the other. I would make it three years for changing the assessment and for making claims refund, and I should make it five years in which to bring suit in both instances.

Senator MCCUMBER. Suppose we make it four years for the one and five for the other.

Dr. ADAMS. It is all right, whatever you decide. We will get it in shape if you will leave it to us.

Senator MCCUMBER. We will consider that agreed to, if there are no objections.

I want to call your attention to subdivision (d) on page 101:

"The amount of tax due under any return made under this act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the commissioner within three years after the return was filed.

"For the taxable year." Is that the way you want that to read?

Dr. ADAMS. That term as used in 250 (d) may give rise to some results that I had not anticipated. I will check it up. It should relate to income and excess-profits taxes, and there should be a general provision at the end of the act relating to other taxes. I do not know how I came to use the word "act."

So far as the income tax is concerned, I want to bring up the suggestion made by Senator McCumber, that in case of a personal service corporation, and possibly others, some method be devised to tax such corporations substantially as partnerships; but to do it in a way which would get around the probable constitutional objections against taxing stockholders on income which has not been paid to them. I talked that over with the Senator, and worked on it. The best thing I have been able to devise is as follows:

That as to these personal service corporations which you desire to bring under this general plan, an additional tax be levied on the corporation of 25 per cent; that thereafter any stockholder who will be agreed to be taxed upon his distributive share of the earnings, whether distributed or not, could, roughly speaking, do it, and the 25 per cent tax would remain on the corpora-

tion only to the extent that the stockholders did not voluntarily undertake to pay normal or surtax upon their distributive shares.

However, we have to guard against that being a losing scheme. In many such corporations, probably most of them, the tax from the individual would be less than the tax from the corporation. In order to avoid that difficulty it is provided that the corporation shall pay the ordinary 15 per cent tax, because that is usually larger than the individual tax, and that the individual, after he voluntarily agrees to pay income tax on his distributive share, shall be credited with that 15 per cent tax. That means if the 15 per cent is high we get the higher amount, and the credit is more than the tax to the individual. If the individual surtax is greater, we get the difference between the 15 per cent paid in the first instance by the corporation and the higher surtax. That is the general scheme.

Senator WATSON. You first put a tax of 25 per cent additional on personal service corporations?

Dr. ADAMS. Yes.

Senator WATSON. Is that to force distribution?

Dr. ADAMS. No. It is to encourage the stockholders to agree to pay on their distributive shares.

I have done the best I could with this. I think it is too much complicated to adopt. It is the simplest thing I know of. I do not think it will work. The difficulty will be what to do with distributions in subsequent years. I think the scheme is too complicated.

Senator MCCUMBER. Your own scheme seems to be rather simple.

Dr. ADAMS. Here is a stockholder in one of these corporations. He pays the tax on his entire distributive share, but other stockholders do not. A few years later the corporation makes a distribution of dividends. Is that paid out of those earlier earnings? If so, to what extent? If each stockholder took a certain position and adhered to it, we could deal with it, but if they are going to be wobbling back and forth, we are lost.

Senator MCCUMBER. You have the same trouble where surplus is distributed at any time. You provide what year that shall apply. You provide first it must be on the last earnings, if they are sufficient to cover it, and if they are not sufficient to cover it in that year, you have to go back into the next year. Why would not the same rule apply here?

Dr. ADAMS. A dividend paid from surplus accumulated since March 1, 1913, is taxable at one and the same rate.

The trouble with the other scheme is that you would have some of the stockholders some years agreeing to pay the tax on their distributive share, and other years refusing to do so. And the problems arising from old stockholders selling and new stockholders buying in would be difficult.

Senator WATSON. What do you think about it, Mr. McCoy?

Mr. MCCOY. I think the committee is on the wrong track. Why do you want to make a distinction between the personal-service corporation under the House bill and any other corporation? Go back to the history of it. Formerly there was no distinction, but when we got the 1918 law we found the personal-service corporations, with practically no capital, would have to pay an enormous excess-profits tax on their earnings. That is the only reason for differentiating it. We put them in a class by themselves and made them partnerships to help them. Why should they need any more help, why should they be taxed any more than any other corporation? They are taxed the same as any other corporation, after the excess-profits tax is eliminated. The 15 per cent tax on corporations and the income tax on the distributive shares leaves them just about the same as if they were a partnership.

Senator MCCUMBER. You are taking the average and leaving out those that make enormous profits.

Mr. MCCOY. No.

Senator MCCUMBER. Of course, you put them in, but you have taken few of those before the ordinary earnings would make that average.

Mr. MCCOY. I can take any case and show there is very little difference.

Senator MCCUMBER. Tell me why a partnership doing business the same as a personal service corporation should be taxed upon all its earnings to the extent of 32 per cent, while a personal service corporation can not be taxed more than 15 per cent.

Mr. MCCOY. If they distribute their profits, they must be taxed more than 15 per cent.

Senator McCUMBER. This is just to prevent their escaping paying taxes by not distributing their profits. That is all this is intended for.

Mr. McCOY. The same trouble would apply to any other corporation. Take a corporation with a capital of $100,000 and four or five stockholders and a personal service corporation with the same income. We would tax them alike. Your argument as to the partnership will apply to the other corporations just as well as to the personal service corporations. Why distinguish between personal service corporations and any other?

Senator McCUMBER. The difference is the others do not make the same profits, because they have a capital invested on which they have determined profits, and the personal service corporation is all profit.

Mr. McCOY. There is no profit determined on capital in this law now. It is upon the net income.

Senator McCUMBER. I did not mean it was determined upon the capital, but they have their capital invested, making a different kind of corporation. A partnership also has its capital invested. Take a law partnership. They have to pay on all their earnings. If a corporation is making $100,000 and does not need to draw more than $10,000 for the use of the stockholders, it can escape taxes on the balance. The partners would have to pay on the entire $100,000.

Mr. McCOY. A personal service corporation with an income of $100,000 would pay a larger tax under the House bill than a partnership would pay.

Senator McCUMBER. Let us vote on the proposition of Dr. Adams.

Senator SMOOT. Dr. Adams, I want to call your attention to page 31, line 14, bonds issued by the War Finance Corporation. Do you think we should have those exempted?

Dr. ADAMS. I think they are exempted. I don't believe in making new exemptions. You have to keep your obligations, but I would not exempt anything new.

Senator McCUMBER. Let me call your attention to one other matter, Dr. Adams, and I will leave it with you. That is the question of cocaine and coca leaves. I have a letter here that is written to Senator Calder which I will read to the committee.

Mr. WALKER. That 1 cent per ounce on narcotics, opium, coca leaves, and so forth, was put on in order to give the Government control of that class of articles. The theory of placing the 1 cent per ounce on originally was in order to make the provision yield about enough revenue to pay what was estimated to be the cost of enforcing it. It is true that the 1 cent per ounce tax upon coca leaves is equivalent to $1.60 per ounce of cocaine. The American manufacturer is placed at a disadvantage, as compared with his foreign competitor manufacturing cocaine, to the extent of $1.60 an ounce. The Treasury has no particular desire, as far as the rates are concerned, if you will provide a rate that will allow them to keep control of it.

Senator CALDER. I move that we make that one-half of 1 cent per pound, and if it is not right we can take care of it in conference.

Mr. WALKER. I imagine that as soon as you reduce the rate on coca leaves you will have somebody here asking you to reduce the rate on opium. The Treasury does not regard that slight distinction of any particular disadvantage as far as American manufacturers are concerned.

Senator McCUMBER. The question is on the motion of Senator Calder to make the rate one-half of 1 cent per pound.

(The motion was lost.)

Senator LA FOLLETTE. On page 197, Mr. McCoy informs me that the reduction of the tax of 2½ cents per gallon on fountain sirups would equalize the cost and make the cost to bottlers 2 cents a gallon. That is in line 21 on page 197 and in line 2 on page 198. I move that that change be made, reducing that tax from 10 cents per gallon to 7½ cents.

(The motion was agreed to.)

Dr. ADAMS. Suggestion has been made that the new taxes in this bill be effective 60 days from the date of the approval of this act instead of January 1. Have you any objection to that?

Senator LA FOLLETTE. Is that reasonable?

Dr. ADAMS. I think so.

Senator McCUMBER. Why not have them all January 1?

Dr. ADAMS. How do you know when you will get the bill through?

Senator McCUMBER. Then you would have to change it with reference to all of them.

Dr. ADAMS. Page 214, line 22, after the word "that" insert "on and after 60 days from the date of approval of this act."

Senator SMOOT. Do you want that to be 60 days?

Dr. ADAMS. What about your new taxes? Suppose you pass your bill December 1?

Senator SMOOT. Then it would begin January 1.

Dr. ADAMS. We need an interval of two months. Both the manufacturers and the department need it. A number of these miscellaneous taxes in the House bill are to take effect immediately. That certainly should not be.

Senator CURTIS. Let us make them all take effect January 1.

(The suggestion was agreed to.)

Senator REED. I wish to call attention to a matter the committee passed on and authorized Dr. Adams to prepare the language. It was a case arising under the decision of the Supreme Court of the United States in the LaBelle Iron Works case, which held that in finding the value of the property they would take the original price at which the property was bought instead of taking its value in 1913. Hughes, Wickersham, and a lot of the most prominent lawyers in the country held that the tax should be based on the value of the property after 1913, but the Supreme Court held otherwise. All I ask is that these people who were caught, some of whom were terribly crippled by it, should be given a period of time in which to amortize or pay these taxes. Somebody has prepared this amendment on this question. The amendment reads:

"In the case of any deficiency (except where the deficiency is due to negligence or to fraud with intent to evade tax) where it is shown to the satisfaction of the commissioner that the payment of such deficiency would result in undue hardship to the taxpayer, the commissioner may, with the approval of the Secretary, extend the time for the payment of such deficiency or any part thereof for such period as the commissioner may determine, not in excess of 18 months from the date this act becomes a law. In such case the commissioner may require the taxpayer to furnish a bond with sufficient sureties conditioned upon the payment of the deficiency in accordance with the terms of the extension granted. There shall be added in lieu of other interest provided by law, as a part of such deficiency, interest thereon at the rate of two-thirds of 1 per cent per month from the time such extension is granted; except where such other interest provided by law is in excess of interest at the rate of two-thirds of 1 per cent per month. If the deficiency or any part thereof is not paid in accordance with the terms of the extension granted, there shall be added as part of the deficiency, in lieu of other interest and penalties provided by law, the sum of 5 per cent of the deficiency and interest on the deficiency at the rate of 1 per cent per month from the time it becomes payable in accordance with the terms of such extension."

I would like to ask that this be adopted in this form.

Senator MCCUMBER. If there are no objections, it will be agreed to.

Have you anything else to present, Dr. Adams? If not, I want to call your attention to page 57, near the bottom of the page.

"In the case of an estate or trust the income of which consists both of income of the class described in paragraph 4 of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and the return made by the fiduciary in accordance with the subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph 4 of subdivision (a), which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries."

Here is a suggested amendment to that provision:

"Whenever in imposing the tax referred to in this section there is a common trustee or trustees acting for the various beneficiaries under substantially the same trust or trusts, the interest of each beneficiary in such trust or trusts shall be treated as a separate trust and returns made to the trust estate accordingly."

Is there any objection to that amendment?

Dr. ADAMS. I should like to look it over.

Senator MCCUMBER. I am willing to turn it over to Dr. Adams, and if he feels it is right to make the amendment, let it be made.

Dr. ADAMS. The next is trivial. It removes the stamp tax on bonds given to protect the Government in case a Liberty bond or a check is lost. We want to take that out.

Senator CURTIS. Let it go out.

(The suggestion was agreed to.)

Dr. ADAMS. Here is a provision that authorizes the Government to make a stamp depository of any State agency authorized to sell the stock transfer stamps of such State. It is covered on page 255. In New York they have a stock transfer tax. They have an agent or agency for the sale of their stamps. We also have a stamp tax on stock transfers. We want to designate under proper safeguards, bonds and so on, the company acting as State agent as a Federal depository authorized to sell stamps, without buying them.

Senator CALDER. Is that the Empire Trust Co.?

Dr. ADAMS. I understand so.

Senator CURTIS. All right. Let us go on.

(The suggestion of Dr. Adams was agreed to.)

Mr. WALKER. You have on page 270 a section which authorizes the commissioner, with the approval of the secretary, to definitely and finally settle these cases. You have also authorized the commissioner to make regulations without retroactive effect. You have also authorized him to validate corporations, based upon personal service corporations for the past four years, in case the personal service corporation provision is held unconstitutional.

Senator MCCUMBER. I think we can adopt those en bloc.

Senator CURTIS. I move they be adopted. Let the experts draw the language to carry out the idea.

Dr. ADAMS. There is one bit of language there I do not feel like using until it is discussed by the committee. It is on page 271.

"No suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

I think it is right, personally. But Senator Simmons and Senator Penrose and others protested against that vigorously.

Senator REED. It occurs to me if you leave that language in that form it deprives a man of his day in court.

Dr. ADAMS. It is only when the taxpayer consents and the Government binds itself equally.

Senator REED. What pressure can be brought to bear on the taxpayer to compel him to give that consent?

Dr. ADAMS. None at all that I know of. That is only for the good of the taxpayer. If it does not help him, it should not be adopted.

Senator CURTIS. I move its adoption.

Senator REED. Senator Smoot, did you have in mind a man in some fiduciary capacity giving that consent, and afterwards the beneficiary who wanted to protest could not do so?

Senator SMOOT. Yes.

Senator CURTIS. Make it read "parties in actual interest."

(The amendment and the suggestion by Senator Curtis were agreed to.)

Dr. ADAMS. Here is a provision to take care of cases like the case in California Senator McCumber mentioned.

Senator MCCUMBER. That should be agreed to.

Dr. ADAMS. I don't think of anything else, except this simplification board. Yes; there is a provision on page 278 which says:

"Any such tax may, under regulations prescribed by the commissioner with the approval of the Secretary, be collected by stamps, coupons, or serial numbered tickets."

That was adopted by the Ways and Means Committee. They wanted to give the commissioner the widest lawful discretion as regards method to stop evasions. It does not go far enough for that purpose, and I think an amendment should be adopted by adding on line 25 the following:

"That whether or not the method of collecting any tax imposed by Titles V, VI, VII, VIII, IX, or X of this act is specifically provided therein, any such tax may, under regulations prescribed by the commissioner with the approval of the Secretary, be collected by stamp, coupon, or serial numbered ticket, or such other reasonable device or method as may be necessary or helpful in securing a complete and prompt collection of the tax. All administrative and penalty provisions of Title XI, in so far as applicable, shall apply to the collection

of any tax which the commissioner determines or prescribes shall be collected in such manner."

(The amendment was agreed to.)

Dr. ADAMS. Page 304. The act establishes a tax simplification board, unsalaried, to expire on December 31, 1924, and to make recommendations concerning simplification of form, three members appointed by the President and three by the Treasury Department, and appropriation of $10,000.

Senator MCCUMBER. If there are no objections, it will be agreed to.

Dr. ADAMS. In line 8 it says "Officers of the United States." I think you had better change that.

(The suggestion was agreed to.)

Dr. ADAMS. There are a couple of other small changes in which Senator Simmons is interested, and I think they might be deferred until he is here.

(Thereupon, at 5.30 o'clock p. m., the committee adjourned to meet again on Saturday, the 17th day of September, 1921, at 10.30 o'clock a. m.)

INTERNAL REVENUE.

SATURDAY, SEPTEMBER 17, 1921.

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

The committee met in executive session, pursuant to adjournment, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, Curtis, Watson, Calder, Sutherland, Simmons, Reed, and Gerry.

Present also: Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief, Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives; and Mr. J. S. McCoy, actuary, Treasury Department.

The CHAIRMAN. The committee will come to order.

Dr. ADAMS. Gentlemen, Senator Thomas has an amendment which would exempt from excess-profits tax for 1917 profits from gold mines. Such a provision is in the revenue act of 1918, and the amendment is to make that retroactive to apply to the 1917 act. I was asked to secure statistics upon the subject. The figures are as follows. I will quote them in round numbers:

There are 128 gold-mining companies which have filed or made returns of one kind or another for the year 1917. Twenty of them reported excess-profits taxes in the amount of $972,000. Of course, they were not all prosperous during the war. Twenty-two thousand dollars of those taxes have already been abated by claims in abatement, and $420,000 are claimed in additional claims for abatement. The man who gave me these figures did not have the papers before him and could not speak with accuracy, but he thinks that the excess-profits tax of the company or companies which Senator Thomas represents was about $400,000.

Senator SMOOT. I take it for granted those $420,000 of claims that have been filed are based on the total profits of the companies.

Dr. ADAMS. I assume profit from gold mining only. These were companies which were classed as gold-mining companies. They probably have a little income from other sources.

Senator SMOOT. I suppose Senator Thomas's amendment would apply only to the gold part.

Dr. ADAMS. Only to the gold part.

Senator LA FOLLETTE. You mean to say by that, Dr. Adams, that this $420,000 claimed may be very greatly reduced?

Dr. ADAMS. I have met few men who have left with me a deeper impression of thorough-going probity and honor than Senator Thomas. I have no notion that he would suggest anything he did not think was right, and I feel that deeply. But I think a proposition to grant a retroactive exemption to those companies which have not yet paid the tax would be most indefensible. I don't see how you can grant it to those who have refused to pay and not give it to those who have already paid. That seems perfectly clear.

The proposition is primarily a question of policy for you gentlemen. There is no question but that gold-mining companies suffered from the war. They had to lose money by reason of the war. Their product can not go up in value, and their costs must go up.

Senator LA FOLLETTE. All of these gold-mining companies produce something besides gold, do they not?

Dr. ADAMS. It differs. Some of them have practically only the gold product.

Senator LA FOLLETTE. In the Black Hills is it all gold?

Dr. ADAMS. I do not know.

Senator SMOOT. There is a cyanide process that is all gold.

Senator LA FOLLETTE. Of course, where they have some other product besides gold they may make during the war period more than would offset what they lose on gold.

Dr. ADAMS. They may make profits during the war on the basis of their original investment. But they can hardly make as much money as they would have made if the war had not occurred. That is irresistible, because their cost goes up and their product is not worth any more.

Senator LA FOLLETTE. Where they get lead and other things that were exceedingly profitable during the war, their profits may more than offset the losses.

Dr. ADAMS. That is probably true.

Senator LA FOLLETTE. Depending upon the proportion.

Dr. ADAMS. Yes.

Senator MCCUMBER. If it is altogether a matter of excess profits, what is the difference what their business is as compared with any other business that pays an excess-profits tax.

Dr. ADAMS. That is the point. We had other industries that suffered during the war. Any company that had for any reason whatever a fixed price which it had to maintain found itself in a similar situation. The theory of the excess-profits tax was that you would assess a tax on an excess profit measured by what—on the value of the property? Not at all. On the cost of the property; what was put into it. The decision was if the corporation made profits above 7 to 9 per cent upon the original investment to tax it. A gold mine, though it has lost by the war, may make money on the basis of its original investment. That was the decision that was made in 1917, and you changed the decision in 1918. It is purely a question of policy.

Senator SMOOT. All Senator Thomas wants is to have the law applied to the tax of 1917 the same as it applied to 1918.

Senator LA FOLLETTE. Would that not eventually be made the basis of demands by other concerns that lost in some direction during the war?

Senator MCCUMBER. If we make it upon the ground that it is to the interest of the country to increase the gold output, that is one thing; but if we make it upon the ground that these companies should be relieved because there was not so much money made, that is another proposition. I do not think there is anything in that, because if they made as much as other companies who paid an excess-profits tax they must have made 18 per cent. I can see no reason on earth why they should not pay it.

Senator SMOOT. The point was that if they made any excess profits it was necessarily on the ore and not on the gold. You could not increase the price of gold and could not make an excess profit on it.

Dr. ADAMS. Roughly stated, you can not make war profits, but you can make excess profits.

Senator LA FOLLETTE. And they were making war profits.

The CHAIRMAN. What is before the committee?

Senator SMOOT. An amendment I offered yesterday, suggested by ex-Senator Thomas, of Colorado, exempting the tax in the act of 1917 on gold companies; that is, on mining companies producing gold, on the amount of gold that was produced by those companies, following the act of 1918. In other words, it is to make the act of 1917 the same as the act of 1918.

The CHAIRMAN. The committee has heard the motion of Senator Smoot. What do you recommend on that, Dr. Adams?

Dr. ADAMS. Personally, I do not think it should be done.

The CHAIRMAN. The question is on the amendment offered by Senator Smoot.

(The amendment was not agreed to.)

The CHAIRMAN. Proceed, Dr. Adams.

Dr. ADAMS. There is one important point we did not discuss that should be discussed. You will remember the net gain and loss provision. You decided to have it apply only to gains and in the new method which has been suggested. Do you want that to go into effect January 1, 1921, or January 1, 1922?

The CHAIRMAN. What do you recommend?

Dr. ADAMS. January 1, 1921.

The CHAIRMAN. The question is on the suggestion of Dr. Adams, that the matter referred to be effective January 1, 1921.

(The question was agreed to.)

Dr. ADAMS. Page 61, dealing with the withholding proposition. The House inserted the word "corporation." This imposes a tax on a debtor corporation,

which hitherto has been on the creditor corporation. It is lines 16 and 17, page 61. I recommend that you disagree.

The CHAIRMAN. It is moved that the committee disagree with the House amendment.

Senator DILLINGHAM. I do not know whether that bears on the question suggested by Senator McLean, extending to the insurance companies the same provisions made to apply to the tax on banks.

Dr. ADAMS. That you have voted on and put in a general plan, relating to "any corporation." That is an entirely different situation.

Senator REED. You want the tax paid by the creditor or corporation, the one that has the money, instead of the one that has to borrow it.

Dr. ADAMS. That is it. That is the present law and represents a decision reached after much discussion. I think the status quo should not be disturbed.

Senator LA FOLLETTE. I move its adoption.

Senator DILLINGHAM. You suggest to strike out what?

Dr. ADAMS. "Or a corporation."

The CHAIRMAN. If there are no objections, those words will be stricken out.

Dr. ADAMS. Do you want to take up the question of a tax commission for the purpose of investigation? I was asked to prepare an amendment on this subject.

The CHAIRMAN. I think we should take it up.

Dr. ADAMS. In the House a proposition was made in the form of an amendment, which was lost through lack of time, which provided for the appointment of a commission, unpaid, consisting of three Senators appointed by the Vice President, three Members of the House appointed by the Speaker, and three members representing the public and appointed by the President. The object was to investigate some of the tax questions which need investigation. I will read the suggested amendment:

"There is hereby established a commission to be known as the commission on Federal taxation (hereafter in this section referred to as the commission), and to be composed of nine members, as follows:

"(1) Three members who shall be Members of the Senate, to be appointed by the President of the Senate;

"(2) Three members who shall be Members of the House of Representatives, to be appointed by the Speaker of the House of Representatives; and

"(3) Three members who shall represent the public, to be appointed by the President.

"(b) Any vacancy in the commission shall be filled in the same manner as the original appointment. The members representing the public shall serve without compensation except reimbursement for travel, subsistence, and other necessary expenses incurred in the performance of the duties vested in the commission by this section. The members who are Members of the Senate and House of Representatives shall serve without compensation in addition to that received for their services as Members of the Congress.

"(c) The Secretary of the Treasury shall furnish the commission with such clerical assistance, quarters, stationery, furniture, office equipment, and other supplies, as may be necessary for the performance of the duties vested in the commission by this section.

"(d) It shall be the duty of the commission—

"(1) To investigate the effect upon the Federal revenues of tax-exempt State and municipal securities, and possible methods of Federal taxation of such securities;

"(2) To investigate the effect of the existing differences in law between the Federal taxation of individuals and partnerships and of corporations;

"(3) To investigate the taxation of expenditures and the reduction of the tax rates upon savings, as means for raising revenue, stimulating thrift, and redistributing the burdens of taxation;

"(4) To investigate the effect of income and profits taxes upon the accumulation and investment of liquid capital; and

"(5) To investigate the Federal estate tax and its relation to State inheritance taxes.

"(6) To investigate the Federal tax system and the methods by which it may be simplified and the burdens of Federal taxation reduced and more equally distributed.

"(7) To make from time to time such recommendations as it deems advisable pursuant to such investigations, and to report on or before the first Monday in December of each year to the President and to the Congress.

"(e) The expenditures of the commission shall be allowed and paid upon the presentation of itemized vouchers therefor, approved by the commission and signed by the chairman thereof. Reimbursement under the provisions of subdivision (b) of the members representing the public, shall be made out of moneys in the Treasury of the United States. All other expenditures of the commission shall be paid one-third out of the contingent fund of the Senate, one-third out of the contingent fund of the House of Representatives, and one-third out of moneys in the Treasury of the United States. For the expenditures of the commission which are to be paid out of moneys in the Treasury of the United States, there is hereby authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, the sum of $5,000.

"(f) The commisssion shall cease to exist on December 31, 1922."

The CHAIRMAN. I thought the original idea was to have three members appointed by the Secretary of the Treasury, experts from the Treasury Department.

Dr. ADAMS. I think Senator SMOOT has something entirely different in mind.

The CHAIRMAN. I think the committee should consider whether the commission should be composed entirely of Government officials or whether outside laymen should be a part of the personnel.

Senator SMOOT. Government officials have already passed on these same questions.

Senator LA FOLLETTE. Have you any recommendation to make with respect to that, Dr. Adams?

Dr. ADAMS. No; I have not. I think you could deal with it more wisely than I. There are many of these questions that do not get proper understanding and appreciation, because they are not canvassed and aired. There are many good proposals the public would be glad to accept, and that you gentlemen would be glad to accept, if you carefully studied them. That is true of some of the proposals dealing with interest from tax-free securities, it is true of the proposed tax on expenditures. It might solve a lot of problems you want solved. Yet it seems so strange and new that I never mentioned it here. If such a commission would air these things, get the facts together and let the people get acquainted with them, I think it would be worth while.

Senator SMOOT. I think we need not put it in this bill, and in the meantime we can make a thorough examination of it and then put it in on the floor of the Senate, if the committee met some time before it was passed and agreed upon it.

Senator REED. I am through voting for commissions. Here is Dr. Adams, who has around him some men I think of a very high order of intelligence. They are studying this tax business and getting the practical side of it and learning its hardships and all that sort of thing. Somebody has to do this work of reformation and improvement in the law. If we appoint or create a commission, it must be men who will give that subject a little of their time. Here are men giving it all their time. I think they are the men to bring forward the new propositions and to have them ready when we come to another revenue bill. In the meantime, if we have meritorious things that need to be given to the public, the suggestions could be sent out to the press and could be aired upon the floor of the Senate and House of Representatives.

Senator LA FOLLETTE. Is it not true that Dr. Adams and the men associated with him are giving all their time to administrative work of the tax laws that we have? I do not believe they would have any time for these investigations.

Dr. ADAMS. There is only one thing to that investigation, and that is the question of airing it—getting it discussed. I do not bring a lot of recommendations to you that in my opinion should be made, nor to the House committee, because the subjects are so strange and novel. You would turn them down, not because they are bad, but because you have not time to go through all the details. Take the sales-tax proposition. Let us assume for a moment that it is sound. It has required thousands of dollars of expenditure and months of the most systematic and careful presentation to the public in order to get it to the place which it now occupies. Advertising, or at least discussion, is a necessary preliminary. There are several suggestions or proposals that deserve airing.

The CHAIRMAN. For instance, what?

Dr. ADAMS. I think a tax on expenditures, if you would look into it, might present a solution of many of our most important tax problems, but it is new and strange.

Senator SUTHERLAND. That is along the Ogden Mills plans?

Dr. ADAMS. Yes.

Senator REED. Your idea is publicity. Is this commission to organize propaganda and put it out in the public press, like this propaganda that was put out in favor of the sales tax? That was heavily financed. I am not criticizing it.

Senator SUTHERLAND. It was not financed at public expense?

Senator REED. No; at private expense. This commission could not start out with such propaganda.

Dr. ADAMS. Not propaganda, but this commission could investigate these subjects and give the public the pros and cons.

Senator LA FOLLETTE. You do have propaganda made where there are selfish interests to be served by it. A committee of this sort would, ostensibly at least, be making investigations and recommendations and discussing propositions generally in the public interest.

Dr. ADAMS. I think that is true.

Senator LA FOLLETTE. That would be a very much broader presentation of the subject than you get under existing circumstances.

Dr. ADAMS. The whole question is whether the commission's report would get wide publicity. If not, I think you should not consider it at all.

(After discussion by the committee the proposition was postponed for possible further consideration.)

Senator SMOOT. I want to call your attention to page 220, line 4, and ask that there be inserted, after the word "act," the words "at less than the fair market value obtainable therefor," so that it would then read as follows:

"That if any person who manufactures, produces, or imports any article enumerated in section 900, or leases or licenses for exhibition any positive motion-picture film containing a picture ready for projection, (a) sells, leases, or licenses such article to a corporation affiliated with such person within the meaning of section 240 of this act at less than the fair market price obtainable therefor the tax thereon shall be computed on the basis of the price at which such article is sold, leased, or licensed by such affiliated corporation."

That is in order to conform with the idea theretofore expressed.

Dr. ADAMS. I think that is all right.

The CHAIRMAN. If there are no objections, the amendment will be made accordingly.

Dr. ADAMS. I have one other thing which is rather important. I have called your attention to the defects of the present law in respect to dividends received from foreign corporations. A person getting a dividend from a foreign corporation is exempt on that as regards normal tax if the foreign corporation is subject to our tax. If it has any of its income subject to our tax, then the domestic recipient of the income gets his dividend tax free. If the foreign corporation is not subject to our tax, he must pay the normal tax on it. The foreign corporation is in complete control of the situation. By buying a bond or otherwise making taxable a few dollars of its income all its dividends come in tax free.

I suggested to the House a very radical remedy. I suggested exemption of dividends from normal tax. This was accepted. It is so sweeping that I think you should consider an alternative method of treatment which I have drafted.

The CHAIRMAN. What page is it?

Dr. ADAMS. Page 44, line 21. The suggestion is to tax the dividends of any foreign corporation deriving less than half its income from this country. If more than half its income is subject to tax, the dividends would be exempt, but if less than 50 per cent is derived from within the United States the dividends would be taxed. I suggest consideration of this substitute for subdivision (a):

"The amount received as dividends (1) from domestic corporations other than foreign-trade corporations or (2) from any foreign corporation more than 50 per cent of the gross income of which for the period of three years ending with the close of its taxable year preceding the declaration of such dividends was derived from sources within the United States as determined under the provisions of section 217."

You should also make a corresponding change in the dividend deductions for corporations in section 234.

Senator REED. I move the suggestion of Dr. Adams be adopted.

The CHAIRMAN. If there are no objections, it is agreed to.

Dr. ADAMS. I have nothing else on that subject.

Senator SMOOT. What about the candy tax that Senator McCumber brought up in relation to the 40 cents a pound? Do you want to change that or take it out entirely?

The CHAIRMAN. I think we ought to restore the candy tax to the existing law.

Senator SMOOT. I have been told, and I think it is true, that the company making the largest amount of candy and the greatest profits in the United States sells their candy at 25 cents a pound.

Senator LA FOLLETTE. What would we get in revenue above the 40 cents?

Mr. MCCOY. A very large revenue. There are several hundred manufacturers retailing it, such as Huyler's and others, that sell no candy at less than 60 cents a pound, and it runs up to $1.50. That is not the children's candy. It is not the cheap adulterated stuff like they had in the House when they passed the bill, which was not fit to eat.

Senator SMOOT. You say we will collect revenue from the retailers that manufacture their own candy. If you are going to get it from them, and not a cent from the real manufacturers of candy, do you not see you are working a discrimination against the small retailer who manufactures his own candy?

Mr. MCCOY. You will collect it from the real manufacturer. There is a good deal of candy sold by the manufacturer at wholesale at 40 cents and more. It is only the cheap stuff that is sold to children at school, that is very much adulterated, that sells for 15 or 20 cents a pound.

Senator SMOOT. I understand that candy which sells for 60 and 75 cents is manufactured for less than 25.

Dr. ADAMS. I know little about that, but I went carefully over the briefs and arguments presented by the candy manufacturers, and without exception they make this point: "Congress is legislating a tax on candy in the belief that they are taxing the dollar candy in the fancy box. But that is only a small part of the business." They repeat that again and again.

Mr. MCCOY. That is where they make their mistake. There are 10 manufacturers that sell their candy at retail; yes, 100 to 1 of these big manufacturers that sell only through jobbers. You will find in this city 10 candy stores that make their own candy to 1 that sells somebody else's candy.

Senator REED. How much of that candy is sold at wholesale for more than 40 cents a pound?

Mr. MCCOY. Forty cents is a very big price. Candy that sells at wholesale for 40 cents retails for a dollar.

(No action was taken by the committee.)

Senator REED. What about our hotel tax?

Dr. ADAMS. Mr. McCoy had that in charge.

Mr. MCCOY. There is no definite estimate you could make. I estimated roughly that a tax of 10 per cent on rooms renting for $5 or more per day would bring in $100,000,000.

Senator REED. Have you drawn a provision?

Mr. MCCOY. No.

Senator SMOOT. What I am afraid of is that the hotels will add the tax to every bill they make out.

Senator WATSON. What effect will it have on the price of rooms if they add that to the price?

Mr. MCCOY. There is one way to avoid that.

Senator WATSON. How?

Mr. MCCOY. Put a tax of 100 per cent on all over $10 a day. If they charge any more the Government is going to get the benefit of it.

(After considerable discussion by the committee, Dr. Adams was requested to prepare an amendment imposing a tax of 25 per cent on the amount in excess of $5 for one person, or $8 for two persons, for sleeping rooms in hotels.)

Dr. ADAMS. I have one other thing, done at the solicitation of the chairman, that is the proposition to allow the taxpayer interest on a refund when the claim is granted. If the taxpayer is required to pay too much tax and he puts in a claim for a refund and it is granted, the Government pays him interest on his money when it is granted. There are three classes. One class is a man who is abiding by a regulation which he thinks is unlawful and pays his tax under protest. If that man gets a refund the interest will go back to the time he pays his tax. Another class is where an additional assessment is made. In that case the interest would go back to the time he pays that additional assessment. The third class is where he makes an innocent mistake and does not discover it, and the Government does not discover it. In that case the interest only goes

back to six months after he files his claim, giving the Government six months to check up the claim. On page 310, after line 4, insert the following new section:

"Upon the allowance of a claim for the refund or credit for taxes paid interest shall be allowed and paid upon the total amount of such refund or credit at the rate of one-half of 1 per cent per month to the date of such allowance, as follows: (1) If such amount was paid under a specific protest setting forth in detail the basis of and reasons for such protest, from the time when such 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 for refund or credit. The term 'additional assessment' as used in this section means a further assessment for a tax of the same character previously paid in part."

Senator REED. I move its adoption.

The CHAIRMAN. If there are no objections, the amendment will be agreed to.

Dr. ADAMS. There is just one more thing. You took off the tax on the little boats. That tax is paid July 1. You repealed that as of January 1, 1922. Mr. Beaman thinks it ought to be repealed as of July 1, 1922.

Mr. BEAMAN. Either do that or provide for a refund of the taxes paid.

The CHAIRMAN. If there are no objections, it will be agreed to.

Are you through, Dr. Adams?

Dr. ADAMS. I am through.

Senator CALDER. Mr. Chairman, page 225, line 4, relating to the jewelry tax. I propose an amendment at the end of the section to provide that the tax shall not apply where the article sold does not exceed in price the sum of $1. Collar buttons, hat pins, cuff buttons, thimbles, etc., articles that are sold at the 5 and 10 cent stores, are taxed.

The CHAIRMAN. Have you figured the amount of revenue that would be lost?

Senator CALDER. I have not.

The CHAIRMAN. Have you any idea, Mr. McCoy?

Mr. MCCOY. It is quite large. In Connecticut and Rhode Island they are sold by the peck measure, and if you are not satisfied with that they throw in another.

The CHAIRMAN. Would this make the purchaser pay a tax every time he buys a cuff button?

Dr. ADAMS. If it is made of any precious metal or an imitation thereof.

The CHAIRMAN. It may amount to considerable. I do not see why it should be exempted.

Senator CALDER. I offer my amendment.

The CHAIRMAN. The question is on the amendment offered by the Senator from New York.

(The amendment was not agreed to.)

Senator SIMMONS. Mr. Chairman, we had up some time ago the discussion of the provision on page 308, beginning with line 19, which relates to the increase in the authorized amount of bonds.

The CHAIRMAN. What is the pleasure of the committee? This is the $7,500,000,000 item on page 308.

Senator REED. Does it not give the Treasury authority to issue new bonds and increase the public debt without congressional authority? I do not think it should have authority to issue a dollar.

Dr. ADAMS. The Secretary of the Treasury under existing law is authorized to issue and have outstanding at any one time $10,000,000,000 of certificates of indebtedness, and as less than $3,000,000,000 are now outstanding it is plain that the Treasury has a margin of $7,000,000,000, which could be used if necessary to meet the expenditures of the Government. The Treasury does not need more borrowing power, but needs it in a different form.

There is a rather sharp restriction as to notes with maturities from one to five years. A large part of the Victory notes maturing in May, 1923, must be refunded or taken up, and it is desired to do this with notes rather than with long-term bonds or with short-time certificates of indebtedness. The amount of certificates outstanding $2,750,000,000, is larger than is desirable, and it is planned to change a part of this indebtedness, from time to time, into the form of notes, I believe.

Senator REED. These certificates of indebtedness were permitted to be issued for the purpose of floating the Treasury over emergencies which I understood at the time, and I think Congress generally understood, were to be taken up out of the current revenues of the year. Now, it appears they have not been

taken up out of the current revenues, and that is to be added to the permanent debt of the country. Is not that where we will come out?

Dr. ADAMS. Not added to the permanent debt. We are reducing the certificates as time passes.

Senator LA FOLLETTE. What do you mean by putting in the words "at any one time"? It is not merely the power of increasing it by $500,000,000, but by many times that, if you leave those words in. That is something new and strange to me.

Dr. ADAMS. In order to refund into note form the Victory notes due in 1923, principally. We have Victory notes of approximately $4,000,000,000 falling due in May, 1923. We have approximately two and three-fourths billions of short-time Treasury certificates outstanding. There is $7,000,000,000 of short-dated debt, in round figures, most of which falls due in 1923. All this could not be paid off in one year. It should be reduced gradually. The question is, How can it best be handled while attempting to reduce it? The idea is to put it into three, four, and five year notes, and, in addition, to put some of the certificate indebtedness, I believe, into this more manageable form.

Senator SIMMONS. What is the amount of those notes?

Dr. ADAMS. Outstanding?

Senator SIMMONS. Yes.

Dr. ADAMS. A small amount at the present time: about $300,000,000, in addition to the original Victory notes.

Senator REED. Would not taking out the word "one" meet the objection of Senator La Follette?

Senator LA FOLLETTE. I think it would.

Dr. ADAMS. This relates to notes for a period of more than one year and not more than five years.

Senator SIMMONS. If you have the privilege now of issuing $10,000,000,000 of certificates and you want to provide for the redemption of these notes, what is the necessity of increasing this?

Dr. ADAMS. You have three main classes of debt. You have the Treasury certificates, which can not exceed, in maturity, more than one year.

Senator REED. How many are there of those?

Dr. ADAMS. There are two and three-quarter billions of those outstanding; $10,000,000,000 are authorized, leaving a margin of $7,250,000,000.

Senator SIMMONS. And you want to increase that?

Dr. ADAMS. Not at all. Distinctly not that.

Secondly, there is a class of notes—meaning thereby obligations—running for a term of more than a year, but not more than five years. That is the second class. That is the class we are interested in here.

Senator CURTIS. How many of those are out?

Dr. ADAMS. Something over $4,000,000,000, I think.

Senator SIMMONS. Of what?

Dr. ADAMS. Of notes. Then you have the long-time debt.

Senator CURTIS. How much of those are authorized?

Dr. ADAMS. Of the notes we now have authority for an aggregate amount of $7,000,000,000. In order to refund the Victory notes, when they fall due, into notes of the same kind, we ask authority to have $7,500,000,000 outstanding at any one time.

Senator SUTHERLAND. That leaves a margin of $3,000,000,000.

Dr. ADAMS. For the time being. We have in addition to that the long-time debt. I have called attention to the Treasury plan of refunding the Victory notes and transferring some of the other short-dated debt into note form. Now, you may like that plan or you may not like that plan. There is one thing, however, that is certain, and that is that this change in the law is not asked for the purpose of meeting current expenditures with loans. We have all the borrowing power we want, but not in the form we want it.

Senator REED. You say that we have the right to issue $10,000,000,000 of certificates now?

Senator SIMMONS. And he wants to add to that $500,000,000.

Dr. ADAMS. No.

Senator WATSON. No; he does not.

Senator REED. Just let me ask Dr. Adams a few question. I think that I can get it right.

The Treasury has a right to issue ten billions of short-term notes?

Dr. ADAMS. Certificates; that is, maturing in a year or less.

Senator REED. And it has issued of these two and three-quarter billions. It has therefore left six and one-quarter billions.

Dr. ADAMS. About seven and one-quarter billions.

Senator REED. It can issue those short-term notes if it wants to.

Dr. ADAMS. Yes; certificates.

Senator REED. Is this proposition in the bill intended to take the place of that seven and a quarter billion?

Dr. ADAMS. No.

Senator REED. Is it intended to be in addition to that?

Dr. ADAMS. We have the seven billion note authorization now, but we want to make it outstanding at any one time.

Senator REED. You have seven billion now and you want $7,500,000,000 more?

Dr. ADAMS. No; not $7,500,000,000 more, but $500,000,000 more; that is, of notes as distinguished from certificates.

Senator REED. You have $7,000,000,000 now. That is not part of the $10,000,000,000?

Dr. ADAMS. No.

Senator REED. So that you have now the right to issue the difference between seven and three-quarter billion and ten billion. That is not used up; you have not used that.

Dr. ADAMS. No.

Senator REED. Let me state it again. When I get into figures I need a guide.

The Government has given the Treasury the right to issue $10,000,000,000. It has issued two and three-quarter billions of ceritficates; therefore, it has seven and a quarter billions left unused, which it can use now for the purpose of raising money on the certificates. Now, it has that power——

Dr. ADAMS (interposing). It has that much leeway.

Senator REED. You want to give, in addition to that, under this bill, the right to the Treasury to issue $7,500,000, or seven and a half billion, in notes?

Dr. ADAMS. We change what was seven billion to seven and a half billion, and in order to refund, ask the right to have that amount outstanding at any one time.

Senator REED. You have got the right to issue ten billion of certificates?

Dr. ADAMS. Yes.

Senator REED. You have used up two and three-quarter billion, which leaves you seven and one-quarter billion that you can still issue.

Dr. ADAMS. Senator, that is a different thing altogether than the seven billion stated here with reference to notes.

Senator REED. You have also, in addition to that, the right to issue $7,000,000,000 of notes, which would give you the right to create an indebtedness of about fifteen billions to-day. Half of it would be in notes and half of it in certificates, or a little over half. Now, you want to let that stand in that way and increase the amount that you can use for notes by adding $500,000,000 of notes to it, so that you would then have the power to issue certificates of indebtedness of some kind—either notes or certificates—to the amount of about sixteen billions. The point I am raising now is this: The whole thing ought to be changed. There ought to be no such power vested anywhere. This clause should be rewritten, in my judgment, and the language should specify that there shall not be any more of these certificates of indebtedness issued except, perhaps, a very small amount, for the purpose of giving leeway, and that then the Treasury should be authorized to fund those debts that come in and not to issue certificates for the funding of them.

Dr. ADAMS. You mean in long-time securities?

Senator SIMMONS. That is my point exactly.

Senator REED. And to fund these certificates that are outstanding into these short-term notes; that is, three or four years. In other words, we ought to take away this vast power that was put in there during the war. I do not care who the man is, and I do not reflect on anybody, for I have the greatest respect for Mr. Mellon—I have great respect for him as a man, and as to his honesty I have no question—but that sort of power was never granted in the world to any executive officer until we granted it during the war, and it was then granted because we had to raise the money, and everybody realizes that it was an unwise thing to do. I would like to have that section rewritten, wiping out this power as it exists now and specifying in the bill just what moneys the Secretary of the Treasury may raise and what certificates he may issue.

Senator SIMMONS. And what amount of certificates he may issue for the purpose of taking up these outstanding certificates?

Senator REED. Yes.

Senator SIMMONS. And what amount of the indebtedness—the outstanding indebtedness—he should be authorized to fund by issuing long-time bonds.

Senator REED. That is what I mean. I think that ought to be rewritten. I think it will not do to leave this bill in this shape. It is one of those tremendous powers created during the war giving to the Secretary of the Treasury powers which were never given before. I think, of course, that the Secretary should have all the necessary power to handle this matter.

Senator SUTHERLAND. We would have to hear the Secretary of the Treasury on that.

Senator REED. I do not object for a moment to giving the Treasury Department power to issue long-time notes under proper restrictions. The $500,000,000 does not frighten me as much as the proposition of leaving in the Treasury Department the right to issue seven and one-quarter billions of these due bills, I will call them—six-month certificates or whatever they are—and then, on top of that, give the Treasury Department the right to issue seven and a half billions more. The fact is that the seven and a half billions—the first ones you spoke of—ought to be wiped out and changed so that that could be employed for the purpose you now speak of.

The CHAIRMAN. Senator Reed, I have had several talks with Mr. McCoy on this subject, and, if the committee will permit it, I would like to have him say a few words. Perhaps he can illuminate the subject.

Senator REED. Very well. I should like to hear him.

Mr. MCCOY. I think I can express the reasoning of the Treasury Department in this matter.

For the calendar year 1923 there are some seven and a half billions of dollars of indebtedness falling due. Under the present conditions, except to a limited extent, we are issuing short-term certificates of indebtedness from six months up to one year. Those certificates lately have been running from 5¼ to 6 per cent. The Government must pay that. If we keep on issuing these short-term certificates, it will increase the amount that will have to be paid in 1923. The obligations of the Government must be met in some way in 1923. The Treasury Department has been very carefully watching the money market and making use of the privilege given in the present law of issuing these notes instead of issuing certificates. For example, this week they have issued $500,000,000 of certificates. Those will become due in December.

Senator REED. Notes, you mean?

Mr. MCCOY. Notes. They issued $500,000,000 of those. All told there were six hundred and fifty million of securities. The rate was 5¼ per cent for the one-year certificates and 5¼ per cent for the six-months certificates. The shorter the term of the short-term securities the lower the rate of interest.

Senator SUTHERLAND. Couldn't there be a transfer?

Mr. MCCOY. You would have to make the transfer often instead of making it twice a year. You do not want to make a rate and later have it run back to 6 per cent. They want the right to watch the market. Once the Government gets past 1923 I think the financing will be practically easy. The idea is to watch the market, and whenever it will pay, or whenever it will guarantee, to issue these notes instead of issuing short-term certificates. That will mean the saving of money.

They have the right to issue $7,000,000,000, all told, of the notes. They are asking the right to issue seven and a half billion. Now, if they issue $7,000,000,000 under the present authorization—and they have brought it up to $5,000,000,000 now—they can not issue any more. If you issue $7,000,000,000 at one time outstanding, as fast as they come in you can issue more.

Senator WATSON. That does not mean a new obligation? It is a transfer from the old to the new?

Mr. MCCOY. Not necessarily. It means that at one time the maximum can be $7,500,000,000, the same as the authorization for certificates is $10,000,000,000. They have issued over $10,000,000,000, but they have been redeemed. They have matured.

Senator SUTHERLAND. What is the rate?

Mr. MCCOY. Five and a half per cent.

Senator REED. But here is the situation. The Government has an agent. It says to the agent; "We authorize you to issue $10,000,000,000 of certificates of indebtedness," and that right still exists. They propose to quit this certificate business practically altogether and they propose to take whatever certificates

they have issued and transmute them into notes, and they propose to substitute for the certificate plan a note plan. Instead of saying that the $10,000,000,000, heretofore authorized to be used in the form of certificates may be used for the purpose of notes, they let the $10,000,000,000 stand and propose an additional $7,000,000,000 to be issued in notes, so that the authority now would be to issue $17,000,000,000 instead of the original $10,000,000,000. That is what it is.

Mr. McCoy. I am afraid you have not got the point, Senator. The idea in issuing the notes instead of certificates is to tide the Government over the period when the Victory notes fall due. They fall due in 1923. If we issue certificates in addition to the $4,000,000,000 of those that we have to redeem, we will have the war savings stamps and everything else to redeem at the same time.

Senator REED. The power is vested in Mr. Mellon to——

Mr. McCoy (interposing). It is not $7,000,000,000 more.

Senator REED. He has the power under the $10,000,000,000 to issue two and three-quarter billion more of certificates. You are going to keep that power and to create a fund of $7,500,000,000 to take up the $2,750,000,000 of certificates outstanding. You are going to thereby increase his power to issue certificates, and in the long run you have put into his hands the power to create an indebtedness, an aggregate indebtedness, of $16,000,000,000.

Senator SMOOT. And decrease the authorization of the short-term securities to the extent of $500,000,000.

Senator REED. If I were going to redraw this I would draw it in this way: I would repeal this law and in lieu of it I would enact one to the effect that the Secretary of the Treasury shall have the authority to issue short-time notes and certificates to the aggregate amount outstanding at any one time of $7,500,000,000—if that is the amount fixed on—that money to be devoted to the following purposes. And then I would specify: To refund certain bonds; to take up certain certificates, and so forth. Then you have by law limited the power of this department.

(Informal discussion followed.)

Dr. ADAMS. I can not speak for the department, but I think the Treasury would be glad to have you authorize $500,000,000 more of notes and deduct $1,000,000,000 of certificates.

Senator CURTIS. The Secretary of the Treasury said it was not his intention to use the certificates, but he wanted to use the notes.

Senator REED. But the Congress in dealing with these enormous sums of money ought to specify where they ought to go and what ought to be done with them.

What is the objection to writing in this bill that we hereby authorize the Secretary of the Treasury to issue obligations in the form of notes and in the form of certificates, at his discretion, to the amount of $7,500,000,000, to be applied to the following purposes? First, to take up two and three-quarter billions of certificates now outstanding; secondly, to take up the five billion dollars of notes now outstanding.

(Informal discussion followed.)

Mr. McCoy. There is no appropriation here. Not one dollar can be expended without authorization from Congress.

Senator REED. Under the authority to issue short-term certificates what can you do? What are they for?

Mr. McCoy. To care for the expenses of the Government until the next tax returns come in.

Senator SUTHERLAND. I think we might inquire of the Secretary what sort of curtailment he would stand for in the power to issue short-term certificates.

Senator SIMMONS. May I ask Mr. McCoy a question? I see here in the financial statement that the Victory Liberty loan Treasury notes amount to $3,856,000,000, in round figures. Then there is series A, 1924, $311,191,000.

Mr. McCOY. Yes.

Senator SIMMONS. That is the short-time indebtedness, is it not?

Mr. McCOY. Those are notes; yes. There was an additional issue of those notes on the 15th of this month of half a million dollars. There was $650,000,000 altogether, but some were certificates of indebtedness.

Senator SIMMONS. Was that a new issue or an issue to take up the old?

Mr. McCOY. An issue to take up the old.

Senator SIMMONS. That did not increase the amount then outstanding?

Mr. McCoy. It increased the amount of certificates—of notes—but it will decrease the amount of certificates. The proceeds received from the notes will redeem the certificates.

Senator Simmons. What is the present aggregate amount of these notes outstanding?

Mr. McCoy. It is close to $5,000,000,000. There has been about $5,000,000,000 issued. Some of them have been redeemed. The sinking fund is being applied to redeem notes that will mature in 1923. Everything is being done to alleviate conditions in 1923.

Senator Simmons. I see that the Treasury certificates tax—that is, the anticipated tax—is $1,644,000,000. That was expected to be paid out of the tax?

Mr. McCoy. Yes.

Senator Simmons. You are not going to pay it out of the tax?

Mr. McCoy. Those were certificates issued in anticipation of the tax.

Senator Simmons. What was the amount of the certificates issued not in anticipation of the tax?

Mr. McCoy. Outstanding now there would be about $2.000,000,000.

Senator Simmons. $2,000,000,000 that were not issued in anticipation of the tax?

Mr. McCoy. Yes.

Senator Simmons. What were they issued for?

Mr. McCoy. To redeem other short-term certificates.

Senator Simmons. And be added to the short-term notes?

Mr. McCoy. No. They have been certificates altogether and are being redeemed with receipts from certificates. There have been only about two or possibly three issues of the short-term notes since Mr. Mellon has been in there.

Senator Simmons. There is only $5,000.000,000 of these notes?

Mr. McCoy. Yes.

Senator Simmons. You want $7,500,000,000. What is the other two and a half billion for?

Mr. McCoy. To take up these certificates.

Senator Simmons. What certificates?

Mr. McCoy. The short-term certificates that are coming due in every three months.

Senator Simmons. Not certificates issued in anticipation of tax?

Mr. McCoy. No; not those.

Senator Simmons. Those are $2,000,000,000?

Mr. McCoy. Yes.

Senator Simmons. Added to $5,000.000,000 that would make $7,000,000,000?

Mr. McCoy. Yes.

Senator Simmons. And you want to put all that in short-term notes?

Mr. McCoy. Yes. They are putting a large amount in notes so that that will push the payments of the Government over 1923.

Senator Simmons. At the price at which the Government can sell long-term bonds, what would be the difference as to the interest rates you are now paying once every year or once every two years or once every three years, thereby paying interest on interest? Have you calculated that in order to ascertain what would be the difference in the interest that the Government would have to pay if it should go on reissuing these short-term notes and if it should fund those notes and put them in long-term bonds?

Mr. McCoy. It is doubtful whether the Government at the present time could issue any considerable amount of long-time bonds at anything less than a 6 per cent rate. It is doubtful whether the Government could do better than that. I believe that the Secretary of the Treasury would be glad to have authority to refund whenever the market guaranteed it.

Senator Simmons. Suppose that bond had the circulating privilege, like all bonds issued before the war. Bonds issued during the war did not have that circulating privilege.

Mr. McCoy. The national banking law is going out of force soon, and the advantage of the privilege is falling off.

Senator Simmons. What do you mean by saying that the banking law is going out of force?

Mr. McCoy. Because the Federal reserve system is taking its place. After a certain date you can not issue more national-bank notes. Federal reserve notes are taking the place of the national-bank notes.

Senator Simmons. Do you know what date that is?

Mr. McCoy. I think it is effective now. It is taking away the circulating advantage or privilege from the bonds.

Senator Simmons. Now you have to pay from 5 to 6 per cent on these short-term notes?

Mr. McCoy. They are falling from 6 now.

Senator Simmons. You have to pay the interest semiannually?

Mr. McCoy. Semiannually; yes. There will be another saving in interest by refunding if the Secretary of the Treasury should have the right to refund at any time that would be of advantage to the Government. If he could have the right to refund at such time as would be of advantage to the Government, it might be a good thing, and not have it at a given date.

Senator Simmons. As I understand you, if we should authorize you to issue new notes for the whole amount of the outstanding short-term notes and the whole amount of the certificates that you say ought to be converted——

Mr. McCoy (interposing). It would amount to $7,000,000,000.

Senator Simmons. $7,000,000,000?

Mr. McCoy. Yes.

Senator Simmons. And that would leave him authority to issue $10,000,000,000 for certificates of indebtedness?

Mr. McCoy. Yes; but it is better to issue longer term notes. It is expensive to issue these short-term notes. It affects the interest rate.

Senator Reed. They have a lot of agents out selling them, have they not?

Mr. McCoy. No, sir. Notice is sent out by the Treasury to the banks, and the banks take them up.

Senator Reed. How about the certificates?

Mr. McCoy. The agents sell only the savings certificates.

Senator Simmons. Can any part of the certificates that the Secretary is now authorized to issue be used for any purpose except in payment of current expenses and in anticipation of taxes?

Mr. McCoy. And in refunding.

Senator Simmons. Yes.

Mr. McCoy. Not one dollar can be used without an appropriation from Congress.

Senator Simmons. Was the $2,000,000,000 that you want to include for certificates originally in anticipation of taxes?

Mr. McCoy. I imagine it was, and it was issued during the war times when the revenue was insufficient.

Senator Simmons. Was there authority for issuing it?

Mr. McCoy. Yes.

Senator Simmons. Then there is authority now.

Mr. McCoy. There is authority to issue now.

Senator Simmons. Then you can issue these certificates for other purposes than in anticipation of taxes?

Mr. McCoy. Yes; that is in the law. He has the same authority to issue them that the Treasury Department had two or three years ago.

Senator Reed. If you will pardon me, Senator Simmons, the Treasury Department for two or three years did issue these certificates and they were issued for the expenses of the Government. If the law remains as it is the present Treasurer can use them and they can be used for the expenditures of the Government, not exceeding the appropriations, but the appropriations might exceed the revenues, in which event these certificates would be used and the indebtedness of the country would be thereby increased.

Mr. McCoy. Yes.

Senator Simmons. Do you mean by that that if we should provide in this bill a fund that will fall of meeting the appropriations and if the money is spent—three hundred million or four hundred millions of dollars—that the Secretary of the Treasury could issue these certificates to pay that debt.

Mr. McCoy. He could. He could do that or the Government could not pay the taxes.

Senator Simmons. And later on we could authorize him to convert those into short-term notes?

Mr. McCoy. Yes.

Senator Simmons. And this language here—"at any time outstanding"—would give that authority?

Mr. McCoy. Yes.

Senator Simmons. So that if we fail to get enough revenue to pay this year's expenses, he can convert these certificates in short-time notes?

Mr. McCoy. He can do that under the present law up to the full authorization; that is, seven billion of notes and ten billion of certificates.

Senator Watson. I move that the authorization be granted.

Senator Simmons. That is very important. The point is that instead of raising enough by taxes to pay the expenses of the Government, you could pay them by these certificates.

Senator Watson. I move that the authorization be concurred in.

(After a vote.)

The Chairman. It is agreed to.

Senator Reed. I want the record to show that I voted against it.

The Chairman. Do you desire an aye and nay vote?

Senator Reed. No; just let the record show that I voted against it.

Senator Gerry. I want it to appear that I voted against it.

Senator Simmons. I also want the record to show that I voted against it.

(Informal discussion followed.)

Senator Smoot. Mr. Chairman, may I now present the substitute for this bill?

The Chairman. Yes.

Senator Curtis. I make the motion that the chairman be authorized to report the House bill as amended by the Senate committee.

Senator Calder. I have several amendments that I want to offer.

The Chairman. Will the committee permit me to call attention to the fact that we have not discussed paragraph (a) on page 309?

Mr. Walker. It has reference to the Liberty bond tax-exempt simplification provision.

The Chairman. It is page 309, paragraph (a). Dr. Adams, what is your thought on that?

Dr. Adams. That is a provision simplifying the various exemptions under the Liberty bond acts. They authorized, from time to time, a number of partial exemptions. Most of them were dependent on the fact that you subscribed to the original issue and held the bonds up to the time of tax payment. The exemptions are very involved and exceedingly cumbersome. They aggregate, as I recall, in all about $100,000 as a possible maximum exemption. The Treasury Department recommends this simplification. The simplification liberalizes the exemptions slightly. It increases the total amount a little, simply because you could not diminish it. The exemptions are so complicated that it seemed to the Treasury Department well worth while to make the change, at the slight cost involved.

Senator Simmons. Can we relieve this Liberty bond tax altogether?

Dr. Adams. Yes; you could exempt them.

Senator Smoot. That will raise the value very quickly.

Senator Simmons. Doesn't it need to be raised?

Senator Smoot. I do not know about that.

Senator Simmons. Millions of them are held by people who paid 100 cents on the dollar for them and are not able to stand the loss incurred by reason of depreciation.

Dr. Adams. What is asked is to authorize the following exemptions:

"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 of the President, [an exemption] on $125,000 aggregate principal amount; and for three years more on $50,000 aggregate principal amount."

Senator Curtis. Two years are up, are they not?

Dr. Adams. No. It says after the expiration of the war between the United States and the German Government.

It is proposed to ignore the conditions that you had subscribed to the original issue and held the bonds up to the present. That is omitted. If you want to go into details, Mr. Walker will read them.

Senator Simmons. Does that mean that if the aggregate amount of bonds held during the two-year period should amount to $125,000 there would be no Federal tax on them?

Dr. Adams (reading). "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 of the President, on $125,000 aggregate principal amount."

Senator Simmons. And $50,000 after that?

Dr. Adams. Yes. I should say, also, that the Treasury Department suggested this primarily to simplify this schedule of the income-tax return.

Senator SIMMONS. Can you tell how much the Government gets from these bonds?

Dr. ADAMS. I do not know of any way to tell.

Mr. MCCOY. There are so many exemptions and they are so complicated on these four and a quarters that not much is paid in income tax. If they were distributed on a basis of equality no income tax would be collected.

Senator SIMMONS. Can you approximate the amount, Mr. McCoy, that is realized from this tax?

Mr. MCCOY. No, sir. This would eliminate it three years after the war.

Dr. ADAMS. I can say this: That the man who knows more about this subject than any other man told me that he knew practically of no corporations that were paying taxes on Liberty bonds; that they kept within the exemption limit with a few exceptions.

Senator SIMMONS. What part of these is escaping taxation by various devices?

Dr. ADAMS. I should think of the Liberty bonds merely a minority are taxed.

Senator SIMMONS. That would be difficult to ascertain, I suppose?

Dr. ADAMS. Yes.

The CHAIRMAN. Is the committee ready for the question? All those in favor of agreeing to the House provision will signify by raising their right hand.

It is agreed to.

Senator SIMMONS. Mr. Chairman, I want to reserve the right to draw up an amendment to be submitted on the floor of the Senate.

Senator CALDER. I have several amendments. The first one is to section 902, page 220. This has reference to the tax on sculpture, paintings, statuary, art porcelains, and so on. The bill now provides, line 20, page 220, "When sold by any person other than the artist." The dealers in these commodities tell me that very often their men go abroad and buy a number of articles and bring them back and divide them among the dealers, and they propose in lieu of the language in line 20, which is, "sold by any person other than the artist," to insert the same language as is used in connection with jewelry, so that it will read, "When sold by or for a dealer for his estate or consumption or use."

Senator LA FOLLETTE. What is the significance of that?

(Informal discussion followed.)

Dr. ADAMS. Do you want to exempt the private individual who sells, and do you want to exempt interdealer sales?

Senator CALDER. I am anxious to protect the interdealer sales.

The CHAIRMAN (after informal discussion). All those in favor of the motion to be drawn up in proper language by the experts will say aye.

It is agreed to.

Senator CALDER. I have another amendment in regard to section 200, page 165.

Senator REED. I would like to amend that by saying that any private citizen may remove not to exceed one barrel of whiskey from a Government warehouse—of his own whiskey.

Senator WATSON. And pay $6.40 tax on it?

Senator REED. Yes.

(Informal discussion followed.)

Senator REED. I think that we should provide that all spirituous liquors shall be taxed $6.40, provided, however, that the liquors that are secured and used exclusively for pharmaceutical purposes shall pay a tax of $2.20.

Senator SMOOT. Do you refer to alcohol at all.

Senator CALDER. I refer to it. It may be that my amendment is not properly drawn.

The CHAIRMAN. I think it should be borne in mind by members of this committee that the committee will meet from time to time and these matters can be taken under consideration.

Senator CALDER. I haven't the amendment in proper shape now. I am going to press this later.

The CHAIRMAN. We will meet frequently and authorize amendments to be submitted.

Senator CALDER. I am going to offer another amendment with reference to a tax on 2¾ per cent beer.

The CHAIRMAN. Do you want to vote on the principle involved with reference to whisky?

Senator CALDER. Yes.

The CHAIRMAN. All those in favor of the additional tax on whisky for beverage purposes, as explained by Senator Calder, will signify by raising their right hand.

Senator SIMMONS. I shall discuss it on the floor.

The CHAIRMAN. It seems to be agreed to, but it is not to be put into the bill, as I understand it. It will be taken up hereafter. Is that the understanding?

Do you want to vote on anything else, Senator Calder?

Senator CALDER. No; I have nothing further at this time.

The CHAIRMAN. Do you want to vote on the beer business?

Senator CALDER. No; not now.

Dr. ADAMS. This is not in the bill.

The CHAIRMAN. This simply expresses the sense of the committee, and someone is to submit to the committee the proposition in proper form and in proper phraseology with any explanations that may be necessary.

Senator CALDER. I have been requested by the real estate men in Philadelphia, New York, and Boston to offer an amendment to exempt real estate corporation from the additional 5 per cent corporation income tax.

The CHAIRMAN (after informal discussion). It ought to apply to all corporations.

Dr. ADAMS. This is too sweeping a thing to do at this stage.

Senator CALDER. I am going to make that more definite and offer it on the floor.

Senator LA FOLLETTE. Mr. Chairman, I have a number of briefs that I have been requested to present to the committee. I ask leave to incorporate then in the record.

The CHAIRMAN. Certainly.

Senator SIMMONS. I have some, too.

Senator REED. I shall reserve the same right.

The CHAIRMAN. This record is really not a record. The stenographers have been asked to take down Dr. Adams's statements with such inquiries as may have been pertinent.

Senator LA FOLLETTE. I understood that we adopted a motion, at the beginning of the sessions, that people who could not be heard would be permitted to present briefs and that those briefs would be printed for the use of the committee and of the Senate.

The CHAIRMAN. Of course any Senator has a right to do anything he chooses in that way, and the stenographer is instructed accordingly, so that any briefs that Senator La Follette, Senator Simmons, or Senator Reed may offer will be printed and put in the public testimony, not on the request of the individual, but on the request of the Senator concerned.

Senator REED. I suppose that Senators have practically all received the same briefs, and there should not be any duplication if briefs are handed in by three or four or five Senators relating to the same subjects.

The CHAIRMAN. The stenographer will make note of that and endeavor to avoid duplication. Mr. McCoy wants to make a statement.

Mr. MCCOY. There was a large umbrella manufacturer from Pennsylvania here who pointed out a way by which the luxury tax might be evaded, under section 900 on umbrellas.

The tax on umbrellas is on the excess of value over $2.50. He said that dealers in umbrellas buy unfinished umbrellas—that is, umbrellas without handles—and pay no tax. Then they buy the handles and simply put the handles on, thereby evading the tax. That will seriously interfere with the umbrella makers and produce no revenue. He suggested the elimination of that tax on umbrellas, and I think the ground is well taken.

The CHAIRMAN. I would like to know what the committee did with candy.

Senator LA FOLLETTE. We changed that on yesterday.

The CHAIRMAN. Are you satisfied with the change?

Senator LA FOLLETTE. I am.

Senator SMOOT. It was 3 cents a pound on all and 10 cents a pound on candy above 40 cents.

Mr. MCCOY. It was 3 per cent on the price at which sold not in excess of 40 cents a pound, and on candy in excess of 40 cents a pound, 10 cents.

Senator LA FOLLETTE. How much revenue would that mean—10 cents above 40 cents?

Mr. MCCOY. It would mean practically all candy made by retail manufacturers. It would not mean dollar candy sold to the retailer; 40 cents is too

high there. Candy that sells for $1 in grocery stores would wholesale at about 30 cents.

The CHAIRMAN. I think we are making this tax a joke in deference to people who have been doing some crude lobbying around this town. Personally, I would leave it either 5 or 3 per cent.

Senator WATSON. Does that bring us up to Senator Smoot's amendment? If so, I move that we take a recess.

Senator CURTIS. I move that the chairman be authorized to report the House bill with amendments made by the Senate committee.

The CHAIRMAN. When the bill is perfected, Senator Curtis moves that it be reported.

Senator WATSON. I move that Senator Smoot offer his amendments.

(Informal discussion followed.)

Senator CURTIS. I move that the committee adjourn until half-past 2 this afternoon.

(Thereupon, at 1.30 o'clock p. m., a recess was taken until 2.30 o'clock p. m. of the same day.)

AFTER RECESS.

Senator SMOOT (presiding). The committee will come to order. I desire to place before the commitee for its consideration H. R. 8245 in an amended form, and as it is not very long I will read it to you [reading]:

"[In the Senate of the United States, Sept. 16, 1921.]

"AN ACT To reduce and equalize taxation, to amend and simplify the Revenue Act of 1918, and for other purposes.

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

"TITLE I.—DEFINITIONS.

"SECTION 1. This act may be cited as the 'Revenue Act of 1921.'

"SEC. 2. Terms defined in the Revenue Act of 1918 shall, when used in the act, unless the context otherwise indicates, have the same meaning as when used in the Revenue Act of 1918, as amended by this act.

"TITLE II.—INCOME TAX.

"Part II. Individuals Surtax: Section 211-A of the Revenue Act of 1918 is amended by striking out all of said provision beginning with 32 per centum of the amount by which the net income exceeds $66,000 and does not exceed $68,000, and substitute therefor the following: 32 per centum of the amount by which the net income exceeds $66,000, said amendment to be effective beginning January 1, 1922.

"TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX.

"Said title is amended by repealing all of the same from Part I, section 300, to and including Part VI, section 331, inclusive, said repeal to be effective on and after January 1, 1921, and substitute therefor the following:

"TITLE III.—MANUFACTURERS' TAX.

"SEC. 300. That in addition to all other taxes there shall be levied, assessed and collected and paid upon every commodity manufactured, produced or imported when sold, leased or liscensed for consumption or use without further process of manufacture a tax equivalent to 3 per centum of the price for which such commodity is sold, leased or licensed; such tax to be paid by the manufacturer, producer or importer.

"SEC. 301 (a). That this title shall not apply to sales, leases, or licenses made during the year in which the total price for which the taxable sales, leases, or licenses are made does not exceed $6,000.

"(b) That in computing the tax under this title every taxpayer shall be entitled to an annual exemption of $6,000.

"(c) That every individual, firm, or corporation liable for any tax imposed under this title shall make monthly returns under oath in duplicate and pay the

taxes imposed by such title to the collector for the district in which is located the principal place of business. Such returns shall contain such information and be made in such time and place and in such manner as the commissioner, with the approval of the Secretary, may by regulation prescribe.

"(d) Taxes levied under this title shall, without assessment by the commissioner or notice from the collector, be due and payable to the collector at the time fixed for filing the return. If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum, for each full month from the time when the tax becomes due.

"SEC. 302 (a). The taxes imposed by the title shall not apply to sales, licenses, or leases made by (1) the United States; (2) any foreign Government; (3) any State or Territory or political subdivision thereof; or the District of Columbia; (4) any mutual ditch or irrigation company; (5) any hospital; or (6) Army or Navy commissaries and canteens; or (7) any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

"(b) The tax imposed by this title shall not apply to sales, licenses, or leases of any article taxable under titles 6 or 7 of the revenue act of 1918.

"(c) Under such rules and regulations as the commissioner, with the approval of the Secretary, may prescribe, the taxes imposed by this title shall not apply with respect to articles sold, licensed, or leased for export and in due course so exported.

"SEC. 303. That in computing the taxes imposed by this title no credit shall be allowed for any tax reimbursed or paid in any manner to any person in connection with any previous transaction in respect to which a tax is imposed by law.

"SEC. 304. That in the case of any erroneous payment of any tax imposed by this Act, any person making any such erroneous payment may take credit therefor against taxes due upon any subsequent return.

"SEC. 305. That the commissioner, with the approval of the Secretary, is authorized to make all needful rules and regulations for the enforcement of the provisions of this title.

"The commissioner, with the approval of the Secretary, may by regulation provide that any return required by this title to be made under oath may, if the amount of the tax covered thereby is not in excess of $10, be signed or acknowledged before two witnesses instead of under oath.

"SEC. 306. That the provisions of this title shall become effective on and after January 1, 1922.

"SEC. 307. That on and after January 1, 1922, title 9, sections 500 to 504, inclusive; title 6, sections 628, 629, and 630; title 8, sections 800 to 802, inclusive; title 9, sections 900 to 907, inclusive; title 10; sections 1000 and 1001, excepting subdivision 12, and section 1003; title 11, section 1100, are repealed except that such sections shall remain in force for the assessment and collection of all taxes which have accrued thereunder and for the imposition and collection of all penalties which have accrued and may accrue in relation to any such taxes."

Gentlemen, that covers the amendments. Perhaps a brief explanation here may be in order. You may want to know just what those titles are, and briefly I will state them.

Title V, sections 500 to 504, is all the transportation taxes and the insurance tax; title 6, sections 628, 629, and 630, is the cereal beverages and the soft drinks and the imports of the same; title 8, sections 800 to 802, covers all admissions and dues; title 9, sections 900 to 907, inclusive, covers all of the excise taxes of every name and nature; title 10, section 1000—which is the capital stock tax—and 1001, which is the broker's tax—then I make an exception in that, subdivision 12, which is the tax for intoxicating liquors; I keep that in. Section 1003 is the tax on boats and yachts. Title 11, section 1100, is the bonds and stamp taxes of all name and nature, and those are what are repealed under the other bill.

The next thing I think I ought to call attention to is, first, the report that was made by the Secretary dated August 4, 1921. We find this: The Treasury estimates the total expenditure for the fiscal year 1922, for which provision should be made out of the current revenues of the Government, will be about $4,550,000,000. Of course, there are the savings to be made out of this, but what I want to do now is to tell you how the bill, with my amendments, will

raise this amount of money, together with the items that we know will be received by the Treasury for the fiscal year.

The normal income tax is $470,000,000, the income surtax $380,000,000. I take those from the Secretary's own estimates. The 10 per cent corporation tax, just as it is to-day, is $450,000,000; the tobacco tax $260,000,000; estate tax, $155,000,000; withdrawal of alcoholic beverages, $75,000,000; 3 per cent manufacturers tax, $1,200,000,000; the tariff, $400,000,000; the salvage of goods, $200,000,000; back collection tax on incomes and profits, $300,000,000; postal receipts, $500,000,000; other miscellaneous revenues, $287,643, or a total of $4,677,643,000; and the estimated expenditures, without the savings suggested by the Secretary, was $4,550,000,000. So we have a surplus there of $127,643,000.

I have not taken into consideration here the question of what we were going to save, other than this: If the department saves what they say they will save, then there will be more money than enough to pay for what judgments may be rendered against the Government at the War Department on account of war contracts or from other sources.

Senator SIMMONS. That is an estimate of what your bill will raise?

Senator SMOOT. Yes; that is, from these items.

Senator SIMMONS. These other things apply to both bills?

Senator SMOOT. These other things are repealed.

Senator SIMMONS. Have you estimated what the bill you have gotten up will yield?

Senator SMOOT. I have made a figure here, taking in everything reported by the Treasury as coming in and everything going out. I think that the bill we have here now, as it is ready to report, would give us about $3,100,000,000.

Mr. MCCOY. Not from your bill. That bill would raise over $2,700,000,000.

Senator SIMMONS. Now, I want to see what we will get under this bill we are about to report, plus the other taxes from other sources.

Mr. MCCOY. Using Senator Smoot's figures of $400,000,000 for the tariff and his figures for salvage and miscellaneous, that would make $3,500,000,000.

Senator SIMMONS. That would be one billion short of the amount.

Mr. MCCOY. Do you include the postal receipts?

Senator SMOOT. That would bring it up to $4,000,000,000. I wanted everything on paper; I did not want to guess at some things and take it for granted we will do some things. This is what we are going to do.

Senator REED. How much do you say the sales tax will raise?

Senator SMOOT. The manufacturers think it will raise $1,800,000,000. I do not; I think with the exemptions it will raise $1,200,000,000. From all sources it is $4,677,643,000.

Senator CALDER. Is that for this year or next year?

Senator SMOOT. That is for the calendar year. Maybe I had better explain postal receipts: We appropriated $542,000,000 for the Post Office Department. If it is self-sustaining, we will get $542,000,000. But I am saying now that on account of the business of this war we are going to lose $42,000,000, and therefore I take $500,000,000.

Senator SIMMONS. As I understand it, under your bill you expect to get $4,600,000,000.

Senator SMOOT. No; not by the bill alone, but from it and all other sources.

Senator SIMMONS. Under the other bill, from all sources, we raise, according to Mr. McCoy, about $4,000,000,000, including postal receipts?

Mr. MCCOY. Yes, sir.

Senator SMOOT. Remember this, I want to be perfectly fair to both bills. We have got to pay out for whatever judgments may be rendered or settlements of accounts that the War Department or the Shipping Board may have. If we did not have those items, then I think $4,000,000,000 would be plenty. But they attempt to meet those by making the savings on the appropriation, and I can call your attention to what they are.

I am presenting to you here a proposition that there is no question about: this is what we will raise; and if there is any money over we can make good use of it. The manufacturers, of course, would like to have this reduced to 2 per cent; I do not want to do it. I do not want the Treasury of the United States to be short of funds; I want them to have ample money to meet every obligation.

Senator SIMMONS. Will you please tell me why the manufacturers are in favor of this tax that is a tax imposed on their business?

Senator SMOOT. I will tell you why it is: The manufacturers are perfectly willing to pay what is necessary to meet the Government's expenses, as far as

their share is concerned. They want to get rid of all this red tape; they want to know just exactly what they have to pay, and they also want it known—and so do I—that whenever this tax of 3 per cent of the manufacture is imposed it is just exactly the same as an expense of manufacturing the goods. The manufacturers of the country are dissatisfied—many of them—because of the discriminations that are made. And from this a man can make out his return; it is so simple that if he does not make it out right it is because he does not want to make it out right. There is nothing here that involves the question of capital stock, patents, or anything of any nature that has made so much trouble in the past. This is a plain proposition that every manufacturer knows just exactly what he has got to pay. He has not got to pay $30,000 out to have accounts in his institution, as some are doing—and some have more than that—and not only that, but every business institution and every individual in the United States, as I say, can make out their returns.

Under this, as far as the $1,200,000,000 is concerned, it is coming in monthly to the Government of the United States.

So far as the $6,000 exemption is concerned—I did not read part of that—but that provides just how it shall be. When a man makes his return he takes an exemption up to $6,000, if his business during the whole year amounts to more than $6,000. It cuts out all of the little fellows; and I want to say here that I first thought I would exempt, specifically, the farmer. Mr. Atkinson, the representative of the farmer's organization, came to my office and said, "I do not want another piece of legislation enacted by Congress specifically exempting farmers by name, in this sense: I think that what you did in your original retail tax bill exempting $6,000, not alone to the farmer, but to everybody else is the proper way to do it." Therefore, I put it in this manufacturers' tax.

Senator SIMMONS. What was puzzling me when you read those exemptions in connection with the monthly payments was how they would get the benefit of that exemption. Take the farmer, for instance. You say he shall make a report every month and pay the tax. How is he going to get his exemption, if he does that; when is he going to get it?

Senator SMOOT. It does not say that, Senator. I did not read the details of it. Suppose a farmer has no returns at all in nine months of the year, and he has them in the three months. The first month that he sells his sales will be $3,000. He makes that return and starts with the $6,000 exemption—sales, $3,000; balance, $3,000; exemptions still due.

Senator CURTIS. And pays them?

Senator SMOOT. He does not pay a cent. Next month his sales are $3,000 again. He simply says "Exemption still due; sales this month $3,000; no balance." He does not pay anything.

Senator SIMMONS. In other words, he takes the total exemption to begin with?

Senator SMOOT. Yes; and deducts whatever the sales are, and deducts $6,000 until exhausted. These are the figures.

Senator SIMMONS. A business man would make his reports, but would not make any remittance until he had exhausted his exemption?

Senator SMOOT. That is it.

Senator SIMMONS. Would not that require every small business man and every farmer who knows he is going to make less than $6,000 to make a return?

Senator SMOOT. Not until he got a return, and the farmer's sales all come in within two or three months.

Senator SIMMONS. But if he sells anything at all, he has got to make a report of that. Every farmer sells something; a good many of them are selling something every month, and so is a small business man selling a little every month. He knows his gross sales are not going to amount to $6,000. Has he got to make a return?

Senator SMOOT. You will remember in my other sales tax I made it quarterly, and the manufacturers generally say, "We very much prefer to make it monthly. Then we know what we have got to pay. We want it monthly, just the same as the wages we have to pay and all other expenses, and not have it pile up for three months, and then there will be three months' taxes to pay at one time."

But I can make this quarterly, if the committee desires to make it so.

Senator SIMMONS. That does not help it at all. Here is a small business man who has been in the business a long time. He never has made $6,000; he does not expect to make $6,000 this year. Has he not under this bill to make a report?

Senator SMOOT. He would if he sold $6,000 worth, unless under rules and regulations where a man is just as sure to-day that he is not going to make $6,000 sales. I think they will require a return. I would recommend that the returns

be required, and I think the department will also. But it will be a printed blank, just the same as they are using to-day in the Philippine Islands, with the totals, and all he has to do is to put the sales in and send it to the department.

Senator SIMMONS. Every man who sells anything at all who comes under your law would have to make a return every month, as I read it, however small the monthly sales may be and however small the yearly aggregates, he would have to make a return every month.

Senator WATSON. I thought your proposition was that he would keep an account and make no returns.

Senator SMOOT. That all depends upon the rules and regulations that may be made by the Treasury Department.

Senator DILLINGHAM. Your plan which you suggest makes it perfectly simple.

Senator SIMMONS. Nothing ought to be left to rules and regulations.

Senator SMOOT. They can make regulations, and that is the only way you can meet over half of the situations existing to-day. They can make a regulation that a man will furnish an affidavit that his sales during the year would not amount to more than $6,000, and that would settle it at once. This is what they furnished me down there as to how it would affect the farmers of the country.

Senator DILLINGHAM. Who furnished that?

Senator SMOOT. The Department of Commerce.

Senator SIMMONS. It not only affects the farmer, but every little operator. There are plenty of manufacturers who are not selling as much as $6,000 worth of stuff a year. Now, to make those people furnish a monthly report would make it very aggravating.

Senator SMOOT. We could provide here, Senator, under the rules and regulations that each person could send in an affidavit that his sales during the year would not be $6,000, and that would be all there would be to it, if we leave it with not even a word said. Here is the average of the farm products sold in the United States in 1913, $1,000; in 1920, $2,000, the highest in the history of the country. In 1921 it dropped to $1,100. Of course, the $2,000 was on account of extremely high prices paid during that year. The Treasury Department say that 495,00 farmers reported no income in 1919, and that is the highest number of any year ever reported. And the average income of those was between $2,000 and $2,500. I asked Mr. Atkinson if he agreed with these figures here, and he told me, "Yes; those are about right."

Senator SIMMONS. There would be any number of farmers who would not have to pay.

Senator WATSON. Yes; and they ought not to have to make a report.

Senator SMOOT. I am perfectly willing to put it in the law as to that provision.

Perhaps it would be just as well to briefly state the taxes to be repealed, just so that you can see at a glance what this means: The excess-profits tax, the transportation tax, telegraph and telephone, all sorts of insurance taxes, every one of them—which I am in favor of anyhow, so far as that is concerned, unless it would require—all nonalcoholic beverages, cereal beverages, carbonated-acid gas, soft drinks, fruit juices, fountain sirups, admissions and dues of every kind; automobiles, trucks, parts, and musical instruments of all kinds, cameras, candy, firearms, electric fans, automatic-slot device machines, all clothing articles, toilet soap and toilet-soap powder, jewelry, all art goods; section 907 entirely—cosmetics and proprietary medicines, corporation capital stock tax; issuance and conveyance of stocks, bonds, etc.; capital-stock transfers, sale of produce on exchanges; and all of the miscellaneous items, the nasty little nagging things that irritate everybody in the United States.

I think that is the substance of my proposal, and if there are any questions you desire to ask I would be very glad to answer them, if I can. In other words, in summing it up in this form, that we raise taxes from a source that there can not be any question of a doubt concerning; and from these sources: The income tax, 10 per cent on net profits corporations, tobacco tax, estate tax, alcoholic beverages, the tariff, and the 3 per cent manufacturer's tax, together with the other miscellaneous revenues that come into the Government every year, whether we pass this bill or whether we would pass any other bills, such as the sales of public lands, and all of the other items that fall into the miscellaneous——

Senator SIMMONS (interposing). Is it the opinion of the manufacturers that they will pay less tax under this proposition?

Senator SMOOT. Some of them will pay less and most of them will pay more. You take a firm, for instance, like the moving-picture concern; that would pay less tax. They are taxed everywhere; they fall in so many brackets. In this tax there is not any doubt but what the moving picture concerns, with all dues out and with other taxes imposed especially upon them, they would pay less tax under this. But manufacturers of all kinds—I mean the great bulk—would pay more tax under this than they do the other way.

Senator SIMMONS. You say, "Because it is more or less vexatious to pay this tax." Do you think that would have sufficient influence? Do you not think—I want to get your opinion about it—that there would be a much larger per cent of the tax under your bill that they could pass on than under this bill?

Senator SMOOT. No; I think they will pass them all along, Senator, outside of proprietary medicines; some of the stamp taxes they will pass on. I know my little drug store has put up a lot of these patent medicines that sell for 50 cents. There is not anything that we make as much money on.

Senator SIMMONS. Have you any doubt about the ability to pass on, and that they do pass on the excess-profits tax?

Senator SMOOT. There is only one case where they would not pass it on, and that is on a rapidly falling market, that they can not dispose of the amount of goods before the market falls to such an extent that they can not dispose of them in that time. In my opinion, taking them as a whole they are passed on not once but passed on in multiplied form.

Soon after we put this excess-profits tax on, I went down to one of the stores to buy a pair of men's gloves. I had bought my son just a little while before a pair of the same gloves, and I thought I would go back and buy myself a pair; and I found there was 50 cents difference. I said, "Why on earth is there 50 cents difference?" He said, "That is on account of the excess-profits tax." There is not any doubt about it that they will pass it on.

Senator DILLINGHAM. I do not recall a manufacturer or wholesaler who has been quizzed but what admitted that they passed the tax on; several admitted they charged up the estimated tax, and did it deliberately, to overhead before they fixed the prices; and then the department store man who came in made the same remark, that they conducted their business in the same way; and they all made that admission.

Senator REED. Where do you put this tax—at the manufacture or at the retail end?

Senator SMOOT. Note the wording of it: "Without further process of manufacture." In other words, let me explain that so you will know. Take an automobile. There are parts manufactured—that is, a complete article—and sold to the man who buys that to replace broken parts in an automobile. That pays the tax, because it is completed manufacture and there is no further manufacture to be made upon it. But if he sells that manufacturer who does mobilize the parts into an automobile it is not taxed, because the automobile is taxed when it is manufactured. So the result of it is this, that we get the 3 per cent once, and once only, and at the time the automobile goes into consumption—that is, into the hands of the public.

Senator REED. Not at the time it goes into consumption?

Senator SMOOT. Without further process of manufacture.

Senator REED. Here is a fellow making engines who buys his cylinders bored from Henry Ford, and then he has to put them through a further process.

Senator SMOOT. That is not taxed.

Senator REED. Suppose that he gets the engine complete from one man, the wheels from another. Does he pay?

Senator SMOOT. If it is assembled, he pays it on the assembled article that is sold to go into use, and no other time. That is one of the troubles that we have in imposing a retail sales tax, because then it is imposed upon every turnover and every step, and then they are integrated, and the nonintegrated comes in there. But nobody has an advantage this way.

Senator REED. This tax, then, is left on the manufacturer, and is, of course, added to the price when it goes to the retailer?

Senator SMOOT. I have no doubt of it at all.

Senator REED. And then the retailer adds a profit upon what he pays; in other words, a profit upon the tax?

Senator SMOOT. That is the case in every kind of tax imposed. But he can not pyramid this and then take each time and each step a profit upon it. Suppose he made 50 per cent, it would be 50 per cent, but only 3 per cent.

Senator REED. How much do you say that will make?

Senator SMOOT. One billion two hundred million.

Senator SIMMONS. Senator Reed, in addition to what Senator Dillingham has said—I do not think you were here when those statements were being made—quite a number of manufacturers were interrogated as to whether they passed the excess-profits tax on. My recollection is they said without exception that of course they passed it on; that they did it by including it in their overhead tax; that they would add that as an item to the cost of production and pass it on. Many of them were asked the additional question, "Do you pass on anything else?" "Well," they said, "we charge a commission for the trouble of the collection of the tax and things of the sort and include that in the overhead charges."

Senator SMOOT. Senator Reed, there was one manufacturer in my office the other night who told us it cost them $30,000 for expert tax accountants and to try to keep their accounts straight so they can make a report under the existing law.

Senator REED. Under this a farmer who brought in a load of potatoes would have to pay that tax?

Senator SMOOT. No; not at all until after he reached the $6,000.

Senator WATSON. If he sold above $6,000 he would, but not otherwise.

Senator SIMMONS. If he sold it to the consumer, for instance.

Senator SMOOT. If it went into potato starches, he would not pay.

Senator SIMMONS. Take cotton under Senator Smoot's proposition: A farmer raises raw cotton. The man who buys that is not the last man who buys it; there is not any tax on that at all, and the same with a great many other articles that might be named.

Senator SMOOT. It does not touch wheat.

Senator SIMMONS. All of those articles purchased for consumption.

Senator SMOOT. Without further process of manufacture.

Senator WATSON. "Without further process of manufacture." Those are the key words.

Senator REED. Potatoes would go in there. But suppose it went to a market man.

Senator SMOOT. If to be consumed, but not if it went to a potato-starch factory.

Senator SIMMONS. But suppose I sent my potatoes to a commission merchant in New York. Could they go in there? Say I put them on the market and sent a carload of them here, and some man dealing in potatoes buys that carload. There is no tax on that under your bill, but that is not for final consumption.

Senator SMOOT. That is produce.

Senator REED. If you had $5,999 sales you would pay no tax?

Senator SMOOT. None at all.

Senator REED. Then it is a tax imposed upon sales in excess of $6,000?

Senator SMOOT. That is right.

Senator WATSON. Senator, why, after you started your sales-tax idea, did you abandon it and change to this plan?

Senator SMOOT. I have said in public many times, and there is not any evasion——

Senator WATSON (interposing). I understand that.

Senator SMOOT (continuing). About it—simply because the situation was such that it brought in so many people and was carried through so many sources to get down to the very person who bought the goods—that is, there were so many people who really did not feel like they wanted to vote for it for those reasons.

Senator WATSON. In other words, your reasons were political?

Senator SMOOT. More than anything else.

Senator DILLINGHAM. The Canadian plan is very similar to this?

Senator SMOOT. The Canadian plan differs in this way: The Canadian plan is upon the manufacturer, the wholesaler, and the jobber to the retailer. But in no case can it be more than two taxes; I have the one. In other words, if a manufacturer is also a jobber in Canada, then he pays 2 per cent. But if the manufacturer sells to a jobber the manufacturer pays 1 per cent, and when the jobber sells he pays 1 per cent, and the result has been in Canada that there is always a conflict as to just what amount of the sales of the jobber was from the manufacturer.

Senator REED. Does that take a tax off of partnerships, etc.?

Senator SMOOT. Outside of just the income tax.

Senator REED. It leaves the income taxes?

Senator SMOOT. I do not change the income tax from what it is now as amended. The tobacco tax is just as it is to-day; the State tax is just as in this bill.

Senator REED. For example, a man bought an article that cost him $3,000. The tax which had to be paid on that article by the manufacturer would be $90, and he would have to pay that $90. That is the way it comes out.

Senator SMOOT. That is the way it works out.

Senator REED. A man bought lumber and built a house. The materials in the house cost him $15,000. The tax upon that would be $450.

Senator SMOOT. Yes.

Senator REED. In every case the man down at the end of the line—the ultimate seller, the retailer—is going to add a profit to this tax, I suppose.

Senator SMOOT. He need not do it unless he wants to.

Senator SIMMONS. If he adds the tax, it will not be on account of this tax, but just because he wanted to.

Senator SMOOT. Mr. McCoy, what do you say the bill we are about to pass will yield?

Mr. McCOY. I have not made the estimates, but I should say, in round figures, about $2,700,000,000.

Senator WATSON. You put 3 per cent tax upon everything?

Senator SMOOT. When it is ready for consumption, after $6,000.

(After informal discussion and consideration of the amendments proposed by Senator Smoot, the committee, at 4.15 o'clock p. m., adjourned, to meet Monday, September 19, 1921, at 10.30 o'clock a. m.)

[Hearings were resumed September 30, 1921.]

INTERNAL REVENUE.

FRIDAY, SEPTEMBER 30, 1921.

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

The committee met in executive session, pursuant to the call of the chairman, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose, presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Curtis, Watson, Calder, Kellogg, Reed, and Walsh.

Present also: Dr. T. S. Adams, tax advisor, Treasury Department; Mr. John E. Walker, chief, Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives; and Mr. J. S. McCoy, actuary, Treasury Department.

Dr. Adams (after informal discussion). Shortly after the Civil War the Congress of the United States, acting on the assumption that the profits of a corporation belong to the stockholders, passed a law and did enforce a law which taxed the profits of the corporation to the stockholders, whether distributed or not, and the Supreme Court decided that it could be done; but later in the stock dividend case this decision was reversed, and the court held that the profit of the corporation does not belong to the stockholder until he gets it.

Senator KELLOGG. Suppose he bought his stock 30 years ago and never had a dividend until 1913, and after 1913 a distribution of the profits is made; are you going to undertake to tax him here?

Senator REED. Can I follow my question just for a moment, Senator?

Senator MCCUMBER. I think, Senator, you ought to bear in mind all the time that this law relates to individuals or corporations, and it relates to the sale of principal. It is capital gain or loss; and this is considered as capital of the person or corporation holding it and is not intended to be a tax upon the stock or the dividend of the corporation, but a tax upon the profit made by the person who owned that stock, either by having it returned to him in full or in part——

Senator REED. I may not get anywhere, but I will at least clear up the matter in my own mind, possibly, by following out this question.

I am going to eliminate all other questions. You have this corporation with its stock worth $1,100 a share. It has a surplus of $10,000,000 and an original capital of $1,000,000. There is nobody who will dispute the fact, in my opinion, that the stockholder has an equitable interest in his proportion of that surplus which has piled up, an interest that he could enforce in a court of equity, provided the management of the stockholders were holding that fund to an unreasonable extent and withholding the benefits of it to the stockholders.

If you will adopt any rule here which proposes to tax that stock, the increase in the value of that stock to the stockholder, you might just as well tax the corporation upon the property as to tax the thing that represents that property in the hands of fifteen or twenty or a thousand people.

That far I am perfectly clear. I do not understand, now, the distinction that the doctor makes in regard to that. You propose, as I understand you, that if I owned a share of stock of this kind and I sold it for $1,100, I would not

pay any tax, because that represents capital. That closes the transaction. What else is there to it?

Dr. ADAMS. Suppose a man had an eleven hundred dollar share of stock, and it was partly based upon earnings accumulated before March 1, 1913. Those earnings are distributed. The rule for which Senator Kellogg contends would say that those earnings shall be tax free—with which I have no particular quarrel, as you will see in a moment. I think it is equitable in its main implication; but it would also say that the stockholder who pays $1,100 for his stock should preserve that $1,100 as his full cost basis in case he subsequently sold.

Senator REED. In other words, you say, then, that if I hold this share of stock and the corporation meets and declares a dividend, distributing a thousand dollars to me——

Senator MCLEAN. At what date?

Senator REED. Now, at this time. But the thing that it is distributing is the $1,100 that was earned before March 1, 1913. You say my stock is only worth $100?

Dr. ADAMS. How much was distributed?

Senator REED. A thousand dollars. If there is any future sale, I then sell that stock for $500, having received the thousand dollars. You say that that should be subtracted from what?

Dr. ADAMS. From the market value of $1,100.

Senator SMOOT. You pay a tax on $400.

Senator KELLOGG. I do not object to that. That is not the question.

Dr. ADAMS. I thought you would not object to it.

Senator KELLOGG. Why, certainly not. I want the stockholder to pay, if he sells his stock, all accumulations of profit from March 1, 1913, to the time he sells it.

Here is what I was objecting to in this bill. If a man buys his stock in 1890 at 25 cents on the dollar and takes no dividend whatever, but allows his dividends to go into surplus until his stock is worth a hundred and twenty on March 1, 1913, if you distribute that $20 a share on the profits which he earned prior to March 1, 1913, although he has never had a cent of dividend you distribute after March 1, 1913, under this bill, if it is more than 25 cents on the dollar—I do not care what Dr. Adams says——

Dr. ADAMS. If you get down to a square issue of what the bill does, I want to respectfully say that the bill does not do that.

Senator KELLOGG. You say right in your report: "* * * 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."

Dr. ADAMS. Let us go on.

Senator KELLOGG. Section 202 simply says that if you sell property for more than you gave for it the difference is the profit.

Dr. ADAMS. I beg your pardon. Section 202 says the difference is profit, but the profit represented by the difference between cost and the March 1 value is not subject to tax, and the only thing subject to tax is the profit above the March 1 value. It says that unmistakably.

Senator DILLINGHAM. You two gentlemen are precisely alike in your judgment of what you want to do. Is it not possible to fix this language so that it is not subject to misunderstanding?

Senator SMOOT. Senator Kellogg, you are reading from the report. Let us take the amendment and read that. Follow the amendment very closely. I think it covers the situation. It is on page 7, down at the bottom. Read the amendment just as it is.

Senator KELLOGG. You have got to read the one before first

Senator SMOOT. Read the other.

Senator KELLOGG. Here is what you have changed: "For the purposes of this act every distribution, except on a bona fide liquidation of the corporation, is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profit accumulated prior to March 1, 1913"—and you have put in the words "may, except as provided in subdivision (c), be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed."

The old law and the House bill stop right there and do not have subdivision (c), such as you have.

Senator SMOOT. Now, read subdivision (c).

Senator KELLOGG (reading): "Any distribution (whether in cash or other property) made by a corporation to its shareholders or members (1) otherwise than out of earnings or profits accumulated since February 28, 1913"——

Senator SMOOT. That is the same as the former paragraph.

Senator KELLOGG (reading): "Or, (2) on a bona fide liquidation of the corporation, shall be treated as a partial or full return of the cost to the distributee of his stock or shares."

Dr. ADAMS. Go on.

Senator KELLOGG (reading). "Any gain or loss realized from such distribution or from the sale or other disposition of such stock or shares shall be treated in the same manner as other gains or losses under the provisions of section 202."

Dr. ADAMS. Now take section 202.

Senator WATSON. How are they treated?

Senator SMOOT. That is what we are going to read.

Senator KELLOGG. Section 202 is a long section.

Dr. ADAMS. Read, if you will, lines 21 to 24.

Senator KELLOGG. I will read the other, first:

"That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property"—

Not the value of the stock.

Senator SMOOT. "Except"——

Dr. ADAMS. That is page 10?

Senator KELLOGG. Yes. Subdivision (b):

"The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a)"—

Which is the difference between the cost and the sale.

Senator SMOOT. "But"——

Senator KELLOGG (continuing). "But 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 shall be the excess of the amount realized therefor over such fair market price or value."

A man may keep his stock. It does not make any difference whether he sells it or not. If he gets any dividends from the prior accumulations more than the cost of his stock, you tax him. He does not sell his stock at all. But suppose you take the value of his stock.

Senator REED. Coming back to our illustration of the $1,100: The stock has not been distributed. It bears very large dividends. Are you claiming that those dividends now should be exempt?

Senator KELLOGG. Not at all. If it earns 500 per cent a year after March 1, 1913, all the earnings from that surplus must be taxed; but if the surplus that was in the Treasury and earned on March 1 is distributed to the stockholders, that is not taxed as against me after March 1, 1913.

Senator SMOOT. It should not be and it is not to-day.

Senator KELLOGG. It is by this bill.

Senator REED. Dr. Adams says he does not want to tax this particular thing that Senator Kellogg says he does tax. It seems to me it ought to be perfectly easy to sit down and change that language so that there is no dispute about its meaning.

Senator MCCUMBER. They will not agree on what they want.

Senator WATSON. I think there is a fundamental difference.

Senator MCCUMBER. Yes; there is.

Senator LA FOLLETTE. Senator Kellogg wants to do something that Dr. Adams says is not fair to the Government to do. Therefore they can not agree about the language, of course.

Senator SMOOT. Senator Kellogg, may I ask you a question?

Senator KELLOGG. Certainly.

Senator SMOOT. Take the case cited by the Senator from Missouri. On March 1, 1913, that stock was worth $1,100. Supposing the company went on until 1920 and all the dividends had been distributed from 1913 to 1920. In that case they would all be taxable. Supposing that one of the stockholders had a share of this stock which was worth $1,100, and he sold that stock. Remember that

all of the earnings had been distributed. Suppose he sold it for $1,200. Do you hold that he should not pay a tax on the $100?

Senator KELLOGG. No.

Senator SMOOT. That is exactly what this says, Senator.

Senator KELLOGG. No; it is taxed whether he sells his stock or not. This does not depend on the sale of the stock.

Dr. ADAMS. Senator Kellogg is entirely right there; but I think that also this is right, that nothing is taxable until you get past the March 1 value.

Senator KELLOGG. I think it is. But assume that it is not, just to meet your idea——

Dr. ADAMS. Can we not put that language in right there?

Senator KELLOGG. Not so far as I am concerned.

Senator SMOOT. Let me go one step farther to see if we agree upon this proposition. Supposing they distributed $800 of that $1,100 worth of stock. What you are complaining of is that they will tax that $800. But supposing he turns around and sells his stock——

Senator KELLOGG. Suppose he never sells it.

Senator SMOOT. Then he would have to pay that tax. If he sold his stock for $400, then he would only be taxed on $100.

Senator MCCUMBER. It is just the same as though they disposed of so much of their capital.

Senator KELLOGG. No; it is not.

Senator REED. Let me ask this question, please, without being interrupted. I am going to take this illustration: A corporation has $10 of surplus to $1 of capital, and it is carrying that up to March 1, 1913. After March 1, 1913, it earns 10 per cent dividend, actually earns it, and declares that 10 per cent dividend, and, of course, the tax would be paid on it, but in addition to that they take a part of this surplus and declare a 50 per cent dividend which really comes out of surplus. Do you claim that is taxed under this bill?

Senator KELLOGG. It is.

Senator REED. And that is the point in dispute?

Senator KELLOGG. It is.

Dr. ADAMS. May I suggest putting in this language in line 4, page 8?

Senator KELLOGG. Let me finish my answer to Senator Reed.

Dr. ADAMS. I beg your pardon.

Senator KELLOGG. I think it is, and Dr. Adams thinks it is. Dr. Adams says that if a corporation had $1,000,000 of capital and $10,000,000 of surplus its stock would be worth on March 1, 1913, $1,100 a share. Suppose the stock had no sale in the market and suppose it were held by three or four men who were practically partners in the concern, like a mercantile company, and there was no market for the stock or that the stock sold for 75 cents on the dollar instead of 110. Dr. Adams will admit, anyhow, that above what the market value was in the distribution of the assets he is taxable, even though all the assets belong to the stockholders.

Dr. ADAMS. They may have bought it at 75 cents the day before.

Senator KELLOGG. Suppose he bought it for 25 cents the day before and it was worth 75 cents on March 1, 1913, and the assets were worth a dollar, and you distributed 25 per cent of the assets acquired prior to March 1, 1913. He would be taxed under this bill, would he not?

Dr. ADAMS. Distributed 25 per cent?

Senator KELLOGG. Yes.

Dr. ADAMS. Not 25 per cent.

Senator KELLOGG. If they distributed 25 cents on the dollar. Suppose they distributed 25 cents on the dollar. He would be taxed, would he not?

Dr. ADAMS. I did not follow your illustration closely enough, Senator.

Senator KELLOGG. Suppose he paid 25 cents for the stock years ago, but that on March 1, 1913, it was selling in the market at 75 cents on the dollar, but the assets and accumulated profits made it worth 100 cents on the dollar, and they distributed 25 cents on the dollar of earnings made prior to March 1, 1913. He would be taxed?

Dr. ADAMS. He would not be taxed. It would count against cost.

Senator KELLOGG. What do you take as the basis of cost?

Dr. ADAMS. 75 cents; and I say the 25 cents would not be taxed, not one dollar of tax upon it.

Senator SMOOT. Then write the bill so that there will not be any question about it.

Dr. ADAMS. You can not write a bill that nobody will misconstrue. If it would make it plainer to put this language in: After the word "distributee," on page 8, line 4, place the following words in parentheses "or if acquired prior to March 1, 1913, the fair market price or value as of March 1, 1913."

Senator KELLOGG. What acquired? Stock, you mean?

Dr. ADAMS. Let us read it with the parentheses in: "or (2) on a bona fide liquidation of the corporation, shall be treated as a partial or full return of the cost to the distributee (or, if acquired prior to March 1, 1913, the fair market price or value as of March 1, 1913) of his stock or shares."

Senator KELLOGG. The fair market value of the assets.

Dr. ADAMS. No.

Senator KELLOGG. But suppose he does not sell his stock.

Dr. ADAMS. There is the fundamental difference at issue between you and myself. You think that if that man bought stock for 75 cents in a corporation in 1912 and gets back 100 cents on the dollar he should pay nothing. I think he should pay on the amount of 25 cents.

Senator REED. Let us see where that brings us, Doctor. Here is a corporation the stock of which is actually worth 10 to 1. It is worth $1,100 a share. It was in that situation prior to March 1, 1913. It has no real market value because of the case that the Senator has put. I come along and am fortunate enough to buy it for $550 a share. I have acquired prior to March 1, 1913, a share of stock worth $1,100 for $550. I have made that much profit. You propose, now, that if I sell that stock after March 1, 1913, that you will tax me on all that I made above the $550—all that I get above the $550—on the theory that I have made that much money. But the fact is that I made the money prior to March 1, 1913, when I purchased the stock, and that I only realized upon it afterwards by selling the stock.

Dr. ADAMS. I do not understand you, Senator. If all the value you had was $550 on March 1, 1913, then I want to do what you say; but we do not go back to the cost of acquisition, earlier than March 1, 1913, where a gain is made.

Senator REED. I want to know if that is your position.

Dr. ADAMS. No; it is not my position. If your illustration is this: Suppose a man bought stock for $550 and it went up to $1,100; would we tax him above $550? No; not at all.

Senator REED. Suppose it has no market value on March 1, 1913, but it has an actual value. What do you do with that?

Dr. ADAMS. We do not recognize the case of having no market value for this purpose. We go back to the assets if necessary. The mere fact that the stock is not on the market does not affect it whatever in the interpretation of the Bureau of Internal Revenue, as I know them. If the corporation has a good sound value and could be sold as a unit for $1,100, the stockholders should be entitled to claim and should claim $1,100 as their starting point for this particular purpose.

Senator REED. How does this work in on that? A man goes out and buys mineral lands. He gets them very cheap and holds them.

Dr. ADAMS. He gets the full value.

Senator REED. How did you get at that value? There is no sale.

Dr. ADAMS. In the first place they make a valuation of the mineral value on the basis of the profits derived from operating——

Senator REED. Suppose they do not operate. Suppose it is idle?

Dr. ADAMS. The best they can do is to make an appraisal.

Senator REED. Take timber lands.

Dr. ADAMS. They go back to the question of sales where possible. It is a very difficult situation to handle; I admit that. All valuations are difficult.

Senator MCCUMBER. There is a fundamental difference between Dr. Adams and Senator Kellogg. Senator Kellogg does not want those things taxed, whether there is a big profit or not, if any part of it is represented by earnings made prior to 1913. In other words, if the stock was worth on the 1st day of March, 1913, $1,100, and the party sells it for that price, he does not want any language that will say that he will be taxed for any part of those profits which were accumulated.

That is his position when we get right down to it. That is what he wants. He does not want them taxed in the hands of the person who made money or in anybody's hands.

Dr. Adams says that if it is sold in such a way that he gets his profit, or if he distributes it, it is equivalent practically to receiving that much; and if

he receives more than it was worth in 1913 for that portion which is distributed—80 per cent or 90 per cent of it may be distributed—he should pay the tax upon the difference between what that portion was actually worth which is distributed or was worth on March 1, 1913, and what he received for it afterwards.

Senator REED. Taking that illustration that we have been using so much, then if the man had stock that was actually worth $1,100 on March 1, 1913, and he was to sell that share of stock and get his $1,100, he would not be taxed?

Senator MCCUMBER. Not a cent.

Senator REED. And if the corporation should declare to him an eleven hundred per cent dividend out of its earnings made prior to March 1, 1913, he still would not be taxed?

Dr. ADAMS. He would not be taxed.

Senator REED. But if the corporation distributed $550 and he sells the property afterwards for $1,100 and has the $550, then the Doctor says that he must now pay upon $550, because $550 of the value of the stock was wiped out by the dividend. He got $550, and the other $550 was carried over.

Dr. ADAMS. Yes.

Senator REED. I do not see what Senator Kellogg wants more than that, myself.

Senator MCCUMBER. The committee will stand adjourned, subject to the call of the chairman.

(Whereupon at 11.55 o'clock a. m. the committee adjourned, subject to the call of the chairman.)

INTERNAL REVENUE.

SATURDAY, OCTOBER 1, 1921.

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

The committee met in executive session, pursuant to the call of the chairman, at 10.30 o'clock a. m., in room 312, Senate Office Building, Hon. Boies Penrose presiding.

Present: Senators Penrose (chairman), McCumber, Smoot, La Follette, Dillingham, McLean, Calder, Simmons, Reed, and Gerry.

Present also: Hon. Frank B. Kellogg, a Senator from the State of Minnesota; Dr. T. S. Adams, tax adviser, Treasury Department; Mr. John E. Walker, Chief Legislative Drafting Service of the United States Senate; Mr. Middleton Beaman, of the Legislative Drafting Service of the House of Representatives.

The CHAIRMAN. The committee will come to order. Senator Kellogg desires to make a further statement to the committee.

Senator KELLOGG. I think I was entirely misunderstood about the constitutional position which I took. It is my opinion that if a corporation made profits prior to March 1, 1913, when the constitutional amendment went into effect, and the profits remained as undivided profits in the corporation and were not distributed, it is beyond the constitutional power of the Congress to levy any income tax upon them without apportioning among the States under the old rule.

I did not intend to deny that if those profits were afterwards distributed in dividends they could be legally taxed to the stockholder, although I said it would be unjust and inequitable in taxing to the stockholder that which could not be taxed directly to the corporation and has not been the policy of the previous tax bills. That is true except from 1913 to 1916, when the law was silent on the subject and the tax was small.

My objection to the Senate amendment is as follows: The law as it now exists, and as the House bill provides, does not tax, when distributed, profits made prior to March 1, 1913. The provision of the bill (subdivision (b)) is as follows:

"But any earnings or profits accumulated prior to March 1, 1913, may be distributed exempt from the tax after the earnings and profits accumulated since February 28, 1913, have been distributed."

The Senate amendment would make those profits taxable. This is taxing to the stockholder indirectly that which could not be taxed to the corporation. It is a discrimination between corporations and as against corporations in favor of partnerships and individuals. Let me illustrate: One corporation for many years prior to 1913 did not pay dividends, but added its earnings to its surplus in order to make the corporation strong. Another corporation paid out its earnings in dividends. The former corporation, if it should distribute its earnings made prior to March 1, 1913, at the present time under this amendment would be taxed; that is, the stockholder would be taxed for the earnings as income although made prior to March 1, 1913. The other corporation, which had paid out dividends to its stockholders, would be free from tax. Now let us see on what basis it is proposed to tax them. The report of the committee, under the head of "Dividends," page 7 of the print I have, stated as follows:

"This amendment provides a general rule for distributions in liquidation and all distributions otherwise than out of earnings accumulated since February 28, 1913 (the latter being statutory dividends); the rule is that such distribution shall be treated as a partial or full return of cost to the distributee of his stock or share, 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."

Now, if I can read the English language, that means this: In 1890 a stockholder purchased his stock for 25 cents on the dollar and received no dividends until after March 1, 1913, but the corporation put its earnings into surplus until the amount of capital and surplus earnings amonted to $120 a share. If the surplus earnings were distributed after March 1, 1913, all over and above the $25 a share—that is, after March 1, 1913, they would be taxed as income to the stockholder provided there was property left in the corporation to the value of $25 a share.

Mr. Adams claims that is not the proper construction of this section, but if you will turn to subdivison (c), as the Senate committee adopted, you will see that "any distribution (whether in cash or other properties) made by a corporation to its shareholders or members (1) otherwise than out of earnings or profits accumulated since February 28, 1913. * * * shall be treated as a partial or full return of the cost to the distributee of his stock or shares. Any gain or loss realized from such distribution * * * shall be treated in the same manner as other gains or losses under the provisions of section 202."

If this does not mean that the profits made prior to February 28, 1913, over and above the cost of his stock shall be taxed, I am unable to understand the English language, and unless there is some direct provision in section 202 to the contrary, I should say the Treasury would construe this as I have claimed. As I read section 202, it fixes merely the basis of determining the gain or loss, and the difference between the cost price of the property bought and the sale price is the gain.

Except in subdivision (b), where it provides that the profit shall be the difference between the market value on March 1, 1913, of property sold and the price at which it is subsequently sold, that, as I read it, refers simply to a sale of property, and does not control the case that I am discussing; but assuming that I am wrong in this regard, simply for the purpose of argument, let us see where it would lead to.

Prof. Adams claims that if the market value of one stock on the 1st day of March, 1913, is 50 cents on the dollar, and the assets of the corporation, including its surplus earnings acquired prior to March 1, 1913, amounts to 100 cents on the dollar, and you distribute 50 cents on the dollar of that stock after March 1, 1913, it is taxable.

I may have misunderstood Prof. Adams's position, but the complete answer is this: Whatever the corporation had on March 1, 1913, was not taxable to the corporation and should not thereafter be taxable if distributed, but all profits made after that, and all profits made by reason of the corporation having that surplus, should be taxed, and if a man sells his stock, the difference between the market value on March 1, 1913, and the price that he got when he sold it, should be taxed; but if he holds his stock he ought to have a right to distribute earnings made prior to March 1, 1913.

Many corporations have no established market value. If the stock was always of the same market value as the asset value, then it would make no difference if you took the market value of the stock as of March 1, 1913, for distribution purposes.

The objection to Prof. Adams's proposition to amend section 201 is as follows: If the market value of one stock on March 1, 1913, was the same as the value of the assets of the corporation, or his proportion thereof, then his proposition would be perfectly fair; but if the market value was less than the value of the assets, his proposition would not be fair.

The proposed amendment by Prof. Adams would, of course, not hurt any man who is able to hold his stock, but a man who is forced to sell his stock, it would be a serious damage to him.

The CHAIRMAN. You may proceed, Dr. Adams.

Dr. ADAMS. Subdivision (b) on page 7 of this section is, for all practical purposes, the present law, except the very important matter in italics, beginning in line 14, which says:

"But any earnings or profits accumulated prior to March 1, 1913, may, except as provided in subdivision (c), be distributed exempt from tax."

Subdivision (c) would, in the case of dividends distributed on earnings prior to March 1, 1913, require those distributions to be deducted from the cost basis which the stock has in the hands of the stockholder. It would be deducted from the cost basis, which includes the March 1, 1913, basis, in case of subsequent sale at a gain. The old law was simply that these distributions from

surplus accumulated before March 1, 1913, would be distributed free of tax and said nothing else. The proposition which I made originally, and which the Senate adopted, was that every time one of those distributions was made it would be counted off against the cost basis of the stock in the stockholder's hands, and if the distributions from surplus exceeded the value or cost basis in the hands of the stockholder you treat the excess as gain and tax it.

The amendment suggested here is that we go back to the basis of the old law and provide that any surplus accumulated prior to March 1, 1913, shall be distributed tax free. That will remain, but it will also be provided that this distribution of such surplus shall be deducted from the cost basis of the taxpayer in case he sold the stock again. The only difference is that we do not tax any gain from the distribution of profits in itself. A man can get back all the accumulated profits of a corporation without tax, but if he subsequently sells his stock that distribution is deducted from his cost basis. Is that plain, Senator?

Senator REED. I have no doubt you have made a plain statement, but I frankly tell you there is nothing about this bill that is plain to me.

Senator LA FOLLETTE. I would like to have Dr. Adams explain what loss of revenue will be occasioned if we adopt this amendment as compared with what it would have been if we had maintained this just as it was written. I want to know whether that is another leak or not.

Dr. ADAMS. The point is you start with an enormous leak in the existing law.

Senator LA FOLLETTE. I understand that.

Dr. ADAMS. I have already proposed what seemed to me to be a fair and equitable way of stopping that leak. There is objection to that?

Senator LA FOLLETTE. Yes; because it would be effective, I take it.

Dr. ADAMS. I would not like to ascribe motives, but there is very strong opposition to it. The proposed amendment does not satisfy me thoroughly, but it will stop 85 per cent of the present leak, I should say.

Senator LA FOLLETTE. The modified amendment you are now suggesting to meet Senator Kellogg's statement?

Dr. ADAMS. The amendment as adopted by the Senate committee in the first instance represented my view of what was thoroughly fair to the taxpayer and thoroughly fair to the Government; in other words, the right solution. There has been the deepest sort of opposition to it. It began with the chairman of the Ways and Means Committee, at which time a similar amendment was defeated. The opposition has continued in the Senate, with men such as Senator Kellogg and Senator Underwood deeply opposed to it. The Secretary of the Treasury, since he presented the original recommendation, has been inclined to change his mind, thinking there was something in the position of Senator Kellogg and Senator Underwood.

Now, then, I have suggested another amendment, which, as I say, will stop—I can not describe it more accurately—85 or 90 per cent of the leak, and rather than lose the whole thing I much prefer to take the 90 per cent. That is the situation, and my judgment is that I will lose it all if I do not take the 90 per cent. If you want a frank statement of it, that is it.

Senator LA FOLLETTE. I think that is what we are entitled to, to know the effect of these amendments.

Senator REED. I do not want to interrupt Senator La Follette, but I hope you will ask Dr. Adams to explain that situation and just how it will operate.

Senator LA FOLLETTE. Yes; I will do that.

Dr. ADAMS. Let us dismiss the statute and I will go on in plain words.

Senator DILLINGHAM. Would it not be well to read the statute and the amendment, so we will have them before us?

Dr. ADAMS. I will do that. The proposed amendment is as follows:

"Page 7, line 15, strike out the words 'may, except, as provided in subsection (c),' disagree to the amendment as shown on line 15, restoring the language of the House amendment and the language of the present law.

"Page 7, line 18, insert the following after the word 'distributed.'"

Senator LA FOLLETTE. You retain subdivision (c), as I understand you?

Dr. ADAMS. No. I am coming to that later. I have stricken out all the italicized language in line 15, and I will put in the 85 per cent clause now.

Senator LA FOLLETTE. That, you think, will stop 85 per cent of the leak?

Dr. ADAMS. Yes. Insert these words, after the word "distributed," on page 7, line 18:

"And shall be applied against and reduce the basis provided in section 202 for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of the stock or shares by the distributee."

In other words, it is suggested that the distributee shall take that distribution of accrued profits into account in case he sells.

Senator LA FOLLETTE. Where is that to be inserted?

Dr. ADAMS. After the word "distributed," in line 18, page 7.

Senator SIMMONS. To take the place of what is cut out, or is it supplementary?

Dr. ADAMS. It is supplementary. It states that if the stock is subsequently sold the basis for computing the gain or loss shall be reduced by the amount of the distribution of profits accumulated before March 1, 1913.

Now, then, on page 7, lines 19 to 23, move to disagree with committee amendment by retaining paragraph (c) of the House bill. That would be to reinsert subdivision (c) there, Senator La Follette.

On page 7, lines 24 and 25, and lines 1 to 8, on page 8, are stricken out.

Senator REED. In other words, Doctor, we take the bill as it comes to us from the House, inserting after the word "distributed," in line 18, page 7, the language which you just read?

Dr. ADAMS. Yes.

Senator LA FOLLETTE. One further question, if I may ask it.

Can you approximate the loss which has been sustained under the existing law and which you aim by the substitute (c) which you have drafted and the italicized words in line 15 to save to the Government?

Dr. ADAMS. Senator, I really do not know how it could be done. If I thought over it a long while, I might be able to give you some approximation. At this time I shall have to answer the question in rather general terms.

There is, in the case of the mining companies and lumber companies, many of them close corporations, and timber companies and companies of that kind, a considerable amount of stock still held by persons who were in the company during the period while surplus was being accumulated prior to March 1, 1913. There is a considerable amount of stock owned now by people who have inherited it, or have bought into such companies, who have bought in later and whose cost basis is likely to be quite high. They paid a good price for their stock. So that when the surplus accumulated prior to March 1, 1913, is distributed it is not likely to give them a taxable gain, because their cost basis is so high they would not get into the taxable gain class.

The first class mentioned, people who bought in early at a low price, would pay tax on their gain, under the amendment as I originally recommended it and as it was originally adopted. I think this is a class of real size and consequence. I do not think it is a matter of extraordinary size and consequence. My best guess now would be that the proposed amendment, what is represented by the 15 per cent not covered, would probably mean at most $15,000,000 a year. The 100 per cent leak would amount to possibly $100,000,000 a year, and I am trying to save 85 per cent of that.

Senator MCLEAN. Let me call your attention to a point I brought up just before you made that statement, covered in subdivision (a) of section 202, on page 10. You say there:

"The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property—real, personal, or mixed—acquired after February 28, 1913, shall be the cost of such property."

The point I wish to call attention to is the language, "The basis for ascertaining the gain derived or loss sustained from a sale or other disposition." It occurs to me you should repeat there the word "distribution," because the sale or disposition applies, as I understand it, to sales not covered by devises and such as that.

Dr. ADAMS. Does not section 201, the one under discussion, subdivision (c) as now drafted, make it perfectly plain that that distribution is to be counted as a sale or other disposition? I should not like to put "liquidation" or "distribution" in section 202 unless I had to. I do not know all its consequences. If section 201, which we are discussing, says plainly that these distributions shall be treated as sale or other disposition, I do not like to put "distribution" in section 202, because it may have some consequence that I do not now see.

Senator MCLEAN. Distributions apply to the declaration of dividends, and if that comes from the accumulation prior to 1913 you do not want to tax it.

Dr. ADAMS. My original proposition as represented by (c) was a double-barrelled gun.

Senator MCLEAN. I know it was.

Dr. ADAMS. That covered it both ways.

Senator MCLEAN. For the purposes of your amendment, I think it would be clearer if you would repeat the word "distribution" there. It might complicate the application of the law in other cases.

Dr. ADAMS. You say on page 10, line what?

Senator MCLEAN. Page 10, line 18: "The basis for ascertaining the gain derived or loss sustained from a sale or other disposition." I would insert the word "distribution."

Dr. ADAMS. That is one of the most sweeping, fundamental provisions of the law. I do not want to put it in there. You have one point in mind that you want to cover, but I do not see the other consequences of it.

Senator MCLEAN. It seems to me, when you refer to section 202, you do not include the dividends, because you do not use the word "distribution," used in the prior section.

Dr. ADAMS. To set all doubts at rest, if you could keep subdivision (c) in section 201, the one under controversy, I should want to set it beyond all possible doubt that the taxpayer was subject to no tax on a gain until he had back his full March 1, 1913, value.

Senator MCLEAN. The point that occurred to me was that it should be done, provided you retain subdivision (c). If you strike that out——

Mr. BEAMAN. Then your suggestion becomes unimportant.

Senator MCLEAN. I do not think it becomes unimportant.

Mr. BEAMAN. Is there anything left of it?

Senator MCLEAN. That does not provide for any distribution. It is merely for sale or transfer by bequest or some other form than distribution.

Mr. BEAMAN. Yes; but if you leave out the second barrel of Dr. Adams's proposition, then the only question is what happens in a sale.

Senator MCLEAN. You still retain "distribution" in your draft of the former section.

Senator SMOOT. The proposition is to eliminate (c) and make the amendment in line 18.

Senator MCLEAN. I am willing to leave it to your judgment, Doctor. I just wanted to call it to your attention.

Senator REED. I am going to ask the committee, for the sake of my coming to understand this and possibly getting it so that others can understand it, to let me ask a few questions without anybody interrupting by suggestion, because we get off the track. I want to go over the ground we went over yesterday when we did not have a stenographer.

I take it, Doctor, that it is conceded now that under the law as declared by the Supreme Court Congress can not take by way of tax the capital which existed and was accumulated prior to the war?

Dr. ADAMS. That is not fully conceded.

Senator REED. Well, it is conceded we are not trying to do that.

Dr. ADAMS. I think that is conceded.

Senator REED. And it is conceded that the Supreme Court did decide that under the law the accumulated profits of a corporation prior to the enactment of the law are not taxable?

Dr. ADAMS. No; I think not. I think you will find that dividends paid from such profits were taxable to the stockholder under the law of 1913, and that a case arose in which the Supreme Court upheld the right and power to levy a tax upon dividends declared after March 1, 1913, and distributed after that date from profits accumulated prior to that date, and such profits are taxed.

Senator REED. The Supreme Court held that a corporation could hold those accumulations and that stock was not taxed. Is that not true?

Dr. ADAMS. It could do that with any profits, whether they were accumulated before March 1, 1913, or after March 1, 1913. That simply brings up the question of the stock dividend.

Senator REED. Yes. The Supreme Court held they could declare a stock dividend, and that dividend represented capital?

Dr. ADAMS. Not on that ground, Senator; not because it represented capital at all. It was on the ground that there had been no separation of profits from the corporation to the stockholder.

Senator REED. They then issued the stock, and that stock was held to be untaxable. Now, what you are trying to do in this bill, regardless of what the Supreme Court decided, was to leave the capital as it existed prior to March 1, 1913, unimpaired, and to levy tax upon the income or profits subsequent to that date. That is what you have been trying to do in this law all the time?

Dr. ADAMS. The existing law of 1918?

Senator REED. Yes.

Dr. ADAMS. I think in a general way that describes the aim and purpose of the act.

Senator REED. I thought we were all agreed on that.

Dr. ADAMS. I think so.

Senator REED. I did not think there would be any dispute about it.

Now, that being the starting point and being the general rule applicable to all cases, I want to bring it to this particular case, and I want to bring it on the same illustration we used yesterday.

A corporation has $1,000,000 of capital stock paid in, originally, years ago. It accumulated prior to March 1, 1913, $10,000,000 of surplus or profits, whether in the form of property or money in bank. Now, you do not intend by this law to take that away from the corporation, do you?

Dr. ADAMS. Not from the corporation at all.

Senator REED. The stockholder in that corporation who had a share of stock found that instead of it being worth $100 it was worth $1,100, by virtue of that accumulated profit. He sold his share of stock just prior to March 1, 1913, and put the money in his pocket. Of course, that transaction would not be reached by this law, would it?

Dr. ADAMS. It would not.

Senator REED. And under the law, if the corporation was to issue, as representing these profits, ten times its original capital stock, allowing the original capital stock to stand outside, that stock distributed would not be taxed under the decision of the Supreme Court.

Dr. ADAMS. The stock distributed would not be taxed.

Senator REED. And if the stock remained just as it was originally and was worth $1,100, does the party holding it have to pay a tax on that share of stock merely because he holds it?

Dr. ADAMS. No.

Senator REED. If he gets a dividend on that stock he has to put it into his income?

Dr. ADAMS. Yes.

Senator REED. And if the stock is worth 11 to 1 on what it was originally, the natural consequence will be that he will get eleven times the dividend that he would have formerly gotten on his stock originally issued, and that increased income to him would go in as part of his taxable wealth?

Dr. ADAMS. I do not agree with that, Senator. I think you are conveying a wrong implication, because most of the corporations concerned or involved do not distribute regularly.

Senator REED. Very well. I am assuming, if they do it, it would go in.

Dr. ADAMS. That is correct. If they distribute cash dividends later, that is correct. It all depends on whether they distributed their earnings accumulated prior to March 1, 1913, or those accumulated later.

Senator REED. I do not care where the dividend comes from. If this institution has stock that is worth 11 to 1, and had it on March 1, 1913, and should to-morrow or from time to time declare dividends upon that very valuable stock, and I am a stockholder and get those dividends, would I not pay tax upon the dividends and have to count them as part of my income?

Dr. ADAMS. You would not have to pay the tax to the extent that the dividends were distributed from profits accumulated before March 1, 1913.

Senator REED. That is the state of the law as it is now?

Dr. ADAMS. That is the state of the law as it is now.

Senator REED. Would that be true if the dividend was not a distribution of previous profits?

Dr. ADAMS. Any earnings accumulated after March 1, 1913, and distributed are taxable.

Senator REED. Now, so that we may be sure to understand each other, I will state it again. Of course, I do not own any stock. I am simply using myself as an illustration. If the dividends which were distributed to me as a stockholder are from earnings of the concern made after March 1, 1913, they

would be part of my income and I would charge them into my income and pay tax upon them. That is right, is it not?

Dr. ADAMS. That is correct. You would pay surtax. The normal tax would be exempt. You would pay the surtax only.

Senator REED. Let us put it in plain language. If the dividends that are declared to me, Doctor, are earnings of the corporation made since March 1, 1913, then I must account for that in my income and pay the same kind of tax upon it that I would if I got a dividend from any corporation that was organized the day before yesterday?

Dr. ADAMS. That is correct.

Senator REED. If, however, instead of the dividend being given to me of earnings made subsequent to March 1, 1913, there was in fact a distribution to the stockholders of profits made prior to March 1, 1913, those profits thus distributed in the form of dividends would not be taxed under the present law, would they?

Dr. ADAMS. They would not be taxed.

Senator REED. Because they are a distribution of wealth accumulated prior to March 1, 1913. That is the theory.

Now, under your amendment what would happen in the case I last put?

Senator SMOOT. Under (c)?

Dr. ADAMS. Under (c) there would be no tax, in the amendment, until the amount of distribution exceeded the value of this stock to the stockholder on March 1, 1913.

Senator REED. Now, I want to find out if you are accurate about that. I want to know whether the thing that determines it is the value of the stock on March 1, 1913, or the cost of the stock to me?

Dr. ADAMS. The thing is unquestionably the value of the stock on March 1, 1913.

Now, Senator, you are assuming the stock was acquired before that date?

Senator REED. I am assuming in this instance that the stock was acquired before that date. I do not want to get at the merits.

Dr. ADAMS. I am not thinking of the merits.

Senator REED. I got this stock, in the illustration I am using, prior to March 1, 1913. It had a value on March 1, 1913, based upon its assets. Now, you say in that case I would pay a tax upon the dividend that was declared to me on the profits made since 1913, but if there was a distribution of the assets in the form of a dividend before that date I would not pay a tax?

Dr. ADAMS. Under existing law?

Senator REED. Under existing law.

Dr. ADAMS. No.

Senator REED. Under your law as now proposed in this amendment what would happen?

Dr. ADAMS. Under the law as proposed in the Senate bill——

Senator REED (interposing) I mean in this amendment we are now discussing?

Dr. ADAMS. I thought you were asking about the Senate bill.

Senator REED. Well, in the Senate bill.

Dr. ADAMS. In the Senate bill there would be no tax in case of a distribution of profits accumulated before March 1, 1913, until the stockholder got back the entire value of his stock as of March 1.

Senator REED. Market value?

Dr. ADAMS. Market value. And I must add to that that the department, in those cases universally, so far as I know to the contrary, insists that there is a market value. It does not dismiss market value because the shares are not sold on the New York Stock Exchange. It gets the fair value that can be obtained.

Under the amendment proposed this morning—do you want to know about that?

Senator REED. Yes.

Dr. ADAMS. There would be no tax under any circumstances upon a distribution of profits accumulated prior to March 1, 1913, but while there would never be any tax on that, the taxpayer's basis for determining gain or loss, in case he subsequently sold his stock, would be reduced by the amount of that distribution of profits accumulated prior to March 1, 1913.

Senator REED. That is to say, going back to this illustration, I have this stock. It was worth $1,100 on March 1. A distributive dividend—that is, a distribution of profits made prior to March 1, 1913—is made of 50 per cent. Therefore, I have received out of my stock $550. Now, if I subsequently sell that stock for

$1,100, notwithstanding I have received this dividend, you say that under this amendment I would be taxed on $550, because I received from my stock a distributive dividend of $550, and then I sold my stock for $1,100, thus getting $1,650 from it, and you say I made that $550 profit because I had already received that amount.

Mr. BEAMAN. Tax free?

Senator REED. Tax free.

Dr. ADAMS. And, in addition, because the value of the stockholder's capital on March 1, 1913, which, I take it, we all want to protect, was only $1,100.

Senator REED. Yes. Now, we have that straight this far, have we?

Dr. ADAMS. I think so. Senator, the situation you last described is under the proposed amendment.

Senator REED. That is what I am talking about.

Dr. ADAMS. Under the original committee bill it works the same way, too.

Senator REED. That is, under the bill as reported by the committee it works out as you have just said in the last two or three answers, and under the new substitute which you are offering in lieu of the committee bill it still works that way?

Dr. ADAMS. It still works that way.

Senator SMOOT. If you will permit me, Senator Reed, I want to ask Dr. Adams if he disagrees with the position taken by Senator Kellogg yesterday, because that was the way Senator Kellogg stated he understood that proposition to be?

Senator REED. Will you not withhold that, Senator? It breaks in on what I am trying to get at, and I am very nearly through.

Senator SMOOT. Go on.

Senator REED. In section 202, which is referred to in this amendment, I find this language:

"The basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property."

Dr. ADAMS. Yes. That is not the principal case you have in mind, but, nevertheless, go on.

Senator REED. Let me see about that. I am going to take this illustration of mine and change it enough to fit this, if I can. I am under some difficulty here, for I am not very familiar with this. In the case just assumed, with this change: I bought a share of stock after March 1, 1913. I was able to buy it for $550, although as a matter of fact the assets of the company were worth $1,100 per share. I got a bargain. That same distributive dividend of $550 was paid to me. Therefore, I am even with the game. I have made all my capital back that I put in, but I still have that share of stock. Now, I sell my share of stock for $1,650, using the same illustration. What do I pay tax on?

Dr. ADAMS. I want to understand your illustration. You bought stock after March 1, 1913, for $550?

Senator REED. Yes.

Dr. ADAMS. And the corporation distributes, from earnings accumulated prior to March 1, 1913, $550?

Senator REED. Yes.

Dr. ADAMS. Then under the Senate bill and under the new proposal in this amendment your basis would be reduced to zero, and if you sold for $1,650 you would be taxed on $1,650. I can not think of any variety of gain or income that is more eligible to taxation than that sort of a gain.

Senator REED. Without arguing the merits, I want to get at what happens. I am assuming that I bought this share of stock before we entered the war, that I bought it before we entered the taxable period, and I got it, as a matter of fact, very cheap. I got it for less than it was worth. Under any of those circumstances the basis for the ascertainment of my value is the cost to me. That is right, is it not?

Dr. ADAMS. The basis is cost, but no gain can be taxed except the gain over the value on March 1, 1913.

Senator REED. Now, Senator Smoot was not as good a dealer as I was. He would be, but he is not in this illustration. He paid, on the same day that I bought my share of stock for $550, $1,650 for a share of the same stock. Both of us sell the stock on the same day for $1,650, and each of us has received this dividend of $550. I pay on a gain of $1,650, and Senator Smoot, who is dealing in exactly the same transaction, would pay on——

Senator SMOOT. Eleven hundred dollars——

Senator REED (continuing). Eleven hundred dollars. That is the way it works out.

Dr. ADAMS. Yes; or in any ordinary sale, if you would buy houses or horses or anything else.

Senator SMOOT. Or merchandise. It works out the same way in all of them.

Senator REED. I was just trying to find how it works out. I will carry the illustration one step further, and then I am through. I bought this stock, now, after March 1, 1913, and I paid $3,000 for the share. I got a dividend of $550, and then I sold the stock for $1,650, and I have lost $800. I am entitled to deduct that loss upon that stock from my income?

Senator SMOOT. You should be.

Senator REED. That is the way that works out?

Dr. ADAMS. Yes.

Senator REED. Doctor, does that not in fact come to this: That if you propose to exempt all capital property from being taken under the tax, that is, property that existed prior to March 1, 1913, if I get this stock and own an interest in this capital, you go back, not to the value of my stock, but to the price I pay for it, and are you not in fact reaching into my capital?

Dr. ADAMS. I do not go back to the price you paid for it, but its value as of March 1, 1913, and the proposed Senate bill goes back to that and to that only, in case you sell at a gain.

Senator REED. I bought this stock for $550.

Dr. ADAMS. When?

Senator REED. Prior to March 1, 1913.

Dr. ADAMS. Yes.

Senator REED. After March 1, 1913, I got $550 dividend, which was distributed from the assets.

Dr. ADAMS. Yes.

Senator REED. I do not pay in that case, you say?

Dr. ADAMS. You will have to put one other point in your illustration or I can not answer your question. You must tell me the value of the stock on March 1, 1913. How much was it?

Senator REED. I am not trying to fence.

Dr. ADAMS. I know you are not, and I am not either.

Senator REED. I have assumed in the illustration that there was a corporation worth $1,000,000 capital paid up, and accumulations of $10,000,000, so that the corporation prior to March 1, 1913, had $11,000,000 of actual assets. Consequently, the real value of the stock was $1,100.

Dr. ADAMS. Senator, I am not a hostile witness. I want to answer your question. The essential point in your illustration is, what was the value of the stock on March 1, 1913?

Senator REED. The real value?

Dr. ADAMS. The fair market value of it.

Senator REED. Let us say that the market value was $1,100, and I went over and bought a share of it for $550.

Dr. ADAMS. That seems a very strange thing that somebody would make you a present of $550. I do not care what it cost you. If the market value is $1,100, here is the answer to your proposition: You can get back $1,100 of those profits accumulated prior to March 1, 1913, without taxation.

Senator REED. No matter what I paid for it?

Dr. ADAMS. You are giving me now a perfectly impossible illustration, but I will say if you bought it for $550 and the market price was $1,100, it is the $1,100 that controls.

Senator REED. I do not think I am giving you an impossible proposition. I think I am giving you the commonest kind of a proposition. There are two classes of stock in this country, broadly speaking. One is stock that is listed upon the exchanges and is bid on daily and has a market value that is just as well established as the market value of wheat. There are other stocks that have no particular market value, and when you go to ascertain that value, if you want to ascertain its value for taxable purposes, you have to go into the question of the assets of the concern. I know many institutions—and I think there is a broad question involved here—where the stock is held by a small number of people, never bartered around very much. Dividends may be very seldom declared, the property being run as an investment or accumulation proposition. Somebody dies or somebody gets hard up and has to have some money, and they sell their interest. Yet, when you come to take an accounting of the

proposition, what they got for their interest might be half or one-third of what the real value is. We are confusing market value. The doctor wants to get away from market value in this situation. Do you not, Doctor?

Dr. ADAMS. I would like to get away from market value, because valuation is always difficult and always to be avoided, if possible; but the mere sale by a distressed stockholder who has to realize money would not, to any man who knows anything about valuation, fix the value of the remaining shares. That is a mere incident.

Senator REED. It fixes the value to that man, because that is the cost to him.

Dr. ADAMS. Senator, if a man could prove that he had, as occasionally happens, acquired a small block of stock at far below its real value, its proper value, we would recognize the proper value and not what he happened to pay for it.

Senator REED. I do not see how you could do that under this section.

Dr. ADAMS. You do not read, if you will permit me to say, the entire section 202.

Senator REED. I want to read it. I want to get right on this. I am not on either side of it.

Dr. ADAMS. I know you are not. The controlling language is found in lines 21 to 24, page 10, or from lines 17 to 24, I should say. It reads as follows:

"The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a)."

Now, up to that point it is cost. Subdivision (a) provides cost. Your suggestion is right. That is cost. But here comes in the main clause. This is the case that you are interested in:

"If its market price or value as of March 1, 1913, is in excess of such basis"—is in excess of cost—"the gain to be included in the gross income"—the gain to be taxed—"shall be the excess of the amount realized therefor over such far market price or value."

That is our fundamental general rule, that in case the property was acquired before March 1, 1913, and is sold at a gain, it is taxable on the gain over the March 1, 1913, value.

Senator SMOOT. Senator Kellogg claims that if there was a timber company organized in 1870, or 1880, and the stock of the organization was sold to the stockholders, not at a dollar but at 25 cents a share; that they went on and accumulated dividends until that stock was worth $1.50 a share—that is, the 25-cent shares would go to $1.50 or $2 a share—that then the value of the stock on March 1, 1913, was, we will say, $2 a share; that after March 1 they make a distribution, and that distribution is made on stock that cost them 25 cents a share; that if that distribution is 50 cents a share, then, without selling stock at all, he is to be taxed on the difference between the 25 cents cost of that stock and the 50 cents that is distributed.

Senator REED. Now, what do you say about that, Dr. Adams? Is that correct?

Dr. ADAMS. That is incorrect, and Senator Smoot will agree with me. It is not taxable at all.

Senator SMOOT. I am telling you what Senator Kellogg's statement is. That is exactly what Senator Kellogg said yesterday, is it not, Doctor?

Dr. ADAMS. I would not like to impute anything to him. I think he did say it, however.

Senator REED. If you will read his argument, you will see that he did state that. That is exactly what was discussed here yesterday.

Now, Dr. Adams says that amendment does not do that, and Dr. Adams's position is that if the stock was worth $2 a share on March 1, 1913, and there was a distribution of $1 a share there would be no tax upon that distribution. Nobody should object to that. Nobody can object. If the distribution was made of $1 a share on that stock as of March 1, 1913, the distribution following that date, and then the man sold his stock for $2 a share, certainly he is only entitled to $1 a share and to be taxed upon the other dollar a share if the sale took place after March 1, 1913.

Senator DILLINGHAM. He would not be taxed on the difference between what he paid for the stock and the present value of it?

Senator SMOOT. No. Dr. Adams, is there any case where distribution is made and where there could be a tax imposed without the sale of the tax?

Dr. ADAMS. Yes, Senator.

Senator SMOOT. It is only in case where the distributions are more than the value as of March 1?

Dr. ADAMS. That is the case. That is the situation Senator Kellogg is particularly interested in.

Senator SMOOT. If there is a distribution of the stock that exceeds the value of the stock as of March 1, 1913, I can not see why it should not be taxed.

Dr. ADAMS. That is the original contention, and there is where I conceded the point to Senator Kellogg. That is what I call the 15 per cent.

Senator REED. Doctor, let us take a very plain case. Take this lumber case, because Senator Smoot is talking about it, and these things may have happened in that case. Twenty-five years ago a company was organized with a million dollars of capital. It went out and bought a lot of timberland, which was very cheap at that time. It held that land and did not do a thing with it; just paid taxes upon it. It had it on March 1, 1913, but at that date that timber could actually be sold for $11,000,000—its original capital and ten times more. There has not been a share of stock sold, there has not been any transaction in it at all. Now it proceeds to sell.

Senator SMOOT. After March 1, 1913?

Senator REED. After March 1, 1913. They put that timber on the market and begin to sell it. It sells one-tenth of the timber, and it declares a dividend of that money, a distributive dividend, of a million dollars.

Senator SMOOT. Being a one-tenth depletion?

Senator REED. The amount they originally put in it being one-tenth of what they received out of the assets. That is distributed. Of course, the fellow that put in $100 for a share of stock has got his money back. Now he sells his stock for $1,100. What is he taxed on?

Dr. ADAMS. Senator, I will have to repeat your illustration to see if I have it right. As I understand, a corporation bought timberland for a million dollars, and it came to be worth $11,000,000 on March 1, 1913?

Senator REED. Yes.

Dr. ADAMS. It held that and sold one-tenth of it in the year 1921?

Senator REED. Yes.

Dr. ADAMS. Or one-eleventh. It sells and gets a profit of one-eleventh. Ten-elevenths would be depletion reserve. That is on the value of March 1, 1913. Is that plain?

Senator REED. It is not plain to me.

Dr. ADAMS. This corporation itself as a corporation is taxable when it sells its timber only on the difference between the price received and the value of the property on March 1, 1913.

Senator REED. On March 1, 1913, it is worth $11,000,000.

Dr. ADAMS. Yes. You said they only sold one-tenth of it. Then they sold $1,100,000.

Senator REED. Put it a million dollars.

Dr. ADAMS. Then you get me mixed up, because your figures are in elevenths. Whatever it may be, one-eleventh is profit and ten-elevenths is value as of March 1, 1913, or, technically speaking, depletion reserve. That is all he is taxed upon. He has $1,100,000 sold, of which $1,000,000 is depletion reserve and $100,000 is profit. The $100,000 of profits accumulated since March 1, 1913, is taxable.

Senator REED. You are not following my illustration. You say it accumulates since March 1, 1913?

Dr. ADAMS. You said the sale took place at that time.

Senator REED. Yes.

Dr. ADAMS. The value of the property is what?

Senator REED. The property originally cost $1,000,000. On March 1, 1913, it was worth $10,000,00. It cut a lot of timber that year and sold it and got a million dollars out of it. That is one-tenth.

Dr. ADAMS. Yes.

Senator REED. What happens in that case?

Dr. ADAMS. You are assuming that it was sold this year at the same value it had March 1, 1913.

Senator REED. Yes.

Dr. ADAMS. There is no profit to the corporation.

Senator REED. If the property since March 1, 1913, had increased in value, had doubled in value, so it was worth $20,000,000, and they sold one-tenth of it, getting $2,000,000, what would happen?

Dr. ADAMS. A million dollars would be profit and taxable, because that had accrued since March 1, 1913. If that were distributed to the stockholders in dividends, it would be taxable. The other million dollars, representing the March 1, 1913, value, or depletion reserve, would, under existing law, under Senator Kellogg's proposition, and under subdivision (c) proposed here, be subtracted from the basis of the taxpayer, would reduce it correspondingly, and would result in no tax unless it exceeded the cost of the stock to the stockholder, or its value as of March 1, 1913, if acquired before that date, and the value as of that date were higher than such cost.

Senator CALDER. If that money was distributed it would be taxable to the stockholder?

Dr. ADAMS. One-half is profits or dividends, and that would be taxable. One-half being the return of March 1, 1913, capital, would count off against the cost basis.

Senator REED. Now, carry it one step further and then I think I am through asking questions.

If I bought a share of that stock subsequent to March 1, 1913, and got it for half its real value, and then got this distributive dividend, that would be subtracted from my value of that stock, and if I sold the stock afterwards the price I paid for it, not its real value, would be the basis. Is that right?

Dr. ADAMS. If acquired after March 1, 1913, you are correct—the distribution from a deflation reserve would be subtracted from the price paid for the stock.

Senator REED. So that any person who bought stock since March 1, 1913, for less than its real value has that stock returned, not according to its real value but according to the price he paid?

Dr. ADAMS. That is correct, I think.

Senator SMOOT (presiding). It is evident we can not get a vote on this to-day, and it is now 5 minutes to 12. The committee will stand adjourned subject to call of the chairman.

(Thereupon, at 11.55 o'clock a. m., the committee adjourned subject to the call of the chairman.)

ADDITIONAL PART FOLLOWS