INVESTIGATION OF BUREAU OF INTERNAL REVENUE

HEARINGS

BEFORE THE

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE UNITED STATES SENATE

SIXTY-EIGHTH CONGRESS

FIRST SESSION

PURSUANT TO

S. Res. 168

AUTHORIZING THE APPOINTMENT OF A SPECIAL COMMITTEE TO INVESTIGATE THE BUREAU OF INTERNAL REVENUE

MARCH 25, 26, 27, 31, AND APRIL 1, AND 2, 1924

PART 2

Printed for the use of the Select Committee on Investigation of the Bureau of Internal Revenue

WASHINGTON
GOVERNMENT PRINTING OFFICE
92919 1924

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

JAMES E. WATSON, Indiana, *Chairman*

JAMES COUZENS, Michigan.
RICHARD P. ERNST, Kentucky.
ANDRIEUS A. JONES, New Mexico.
WILLIAM H. KING, Utah.

CONTENTS

INVESTIGATION OF BUREAU OF INTERNATIONAL REVENUE

TUESDAY, MARCH 25, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met, pursuant to adjournment, at 2 o'clock p. m., Senator William H. King, presiding.

Present: Senators King and Couzens.

Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. N. T. Hartson, soiicitor, Internal Revenue Bureau; and Mr. S. M. Greenidge, chief, engineering section, Internal Revenue Bureau.

Senator KING. The committee will be in order.

Senator COUZENS. Has Mr. Nash or Mr. Hartson brought here to-day from the department the reports that were asked for?

Senator KING. I asked for some information yesterday. I do not know whether you have had time to procure that or not.

Mr. NASH. Mr. Chairman, it was impossible to get the information you asked for with reference to Messrs. Mapes, Angevine & Johnson, which is the firm name. It will take some time to get that information.

Senator KING. All right.

Mr. NASH. I have a statement from the Secretary to present to the chairman of the committee. Do you wish me to read it?

Senator KING. Let me see what it is.

Senator COUZENS. I think you should read that for the benefit of the committee.

Mr. NASH (reading):

DEAR MR. CHAIRMAN: In the hearing before your committee yesterday what purported to be a copy of a memorandum delivered by an ex-employee to a member of your committee was introduced and has been made the basis for headlines in the newspapers which might lead the public to believe I had sought to influence the Bureau of Internal Revenue in its consideration of the tax liability of certain companies in which I am interested as a stockholder. As I have already stated, I have never interfered in any way with the Bureau of Internal Revenue in any tax matter, least of all would I do so in cases in which it might be charged that I was personally concerned. I feel, however, that it is due to me and to the companies involved that your committee make an immediate investigation in order that you may thoroughly satisfy yourself and the public whether or not these companies have received any favors from the Government.

Three companies which have been mentioned are the Gulf Refining Co. and its subsidiaries, the Standard Steel Car Co. and the Aluminum Co. of America. Each of these companies has advised the Commissioner of Internal Revenue that it waives its right to privacy under the statute, and the commissioner is

authorized to produce to your committee, without restriction of any kind, all of the tax returns and accompanying papers for each tax year. Messrs. Ernst & Ernst, certified public accountants, are familiar with the tax adjustments of these companies, since they handled their presentation before the bureau. They can undoubtedly be of assistance to your committee in explaining the complicated questions involved, and I am informed are ready to respond to any call of your committee. Mr. A. C. Ernst will be in Washington on the 26th and will be available then or thereafter. If question is later raised with respect to any other companies in which I may be interested, I shall be glad to do what I can to obtain similar publicity to their returns.

Very truly yours,

A. W. MELLON, *Secretary of the Treasury.*

HON. JAMES E. WATSON,
Chairman Committee to Investigate the
Bureau of Internal Revenue, United States Senate.

Senator COUZENS. We had asked for some other information; for instance, the synopsis of the Gulf Oil Co. and my own. We asked for that yesterday.

Mr. NASH. Yes. Mr. Hartson has prepared a synopsis of our case, Senator Couzens, and our engineers worked until midnight last night, and have worked up until just before coming to the committee to-day, to prepare the Gulf Co.'s case. It has been physically impossible to complete that synopsis.

Mr. Greenidge, the head of the engineering division, is here with us to-day, and he can explain to the committee just how much they have done and how much longer it will take to complete that synopsis.

Senator COUZENS. Have you the other cases here, then?

Mr. NASH. Mr. Hartson has your case, Senator.

Senator COUZENS. I do not assume that there is anything we can do but to give you time to complete that record.

Senator KING. Yes; we will have to give them time.

Have you anything else to-day, Senator?

Senator COUZENS. Nothing except the filing of this report of mine. I would like to hear Mr. Hartson as to that.

Mr. NASH. Mr. Greenidge will be able to tell you how long it will take to complete that work.

Mr. GREENIDGE. We hope to do so by Friday, Senator. I should like, however, to ask, if you will indicate in more or less detail how far we should go in supplying this information to the committee. You see, with a large case of that kind, the chronological record alone is a matter of probably hundreds of items. The figures that are involved are large and complicated, and the reconciliation of those is not altogether an easy matter. Just how far do you wish us to go into an explanation of the details, or otherwise? We would be very grateful to have your suggestions in regard to that.

Senator KING. Senator, have you any thought in that connection?

Senator COUZENS. I thought in this report they might show the particular controverted points. I do not conceive that that requires the whole history of the case, and certainly I have no desire to burden either the record or the department with volumes that we can never look at; but it does seem to me that they could point out in this synopsis the questions at issue, the position that was originally taken by the Government, the position that was taken by the committee, how the case was settled, whether it was a compromise or upon its merits, and who settled it.

Senator KING. Essentially those figures involved in what you call the reconciliation, because there probably is where the crux of the

matter lay; but the statement made by the Senator, I assume, is correct.

Mr. GREENIDGE. Yes; that gives us the information we would like to have. We have not lost any time so far because of the work that we have done, Senator. It will tend to amplify all the points that you wish us to cover in a general way.

Senator COUZENS. Of course, if, after going through the records, anything occurs to us that we would like to have, we can get that later on.

Mr. GREENIDGE. Yes. You see, this chronological record will permit us to refer to it very easily hereafter.

Senator KING. Do you understand the records that we are after?

Mr. GREENIDGE. Yes; and I will have a transcript of the instructions, no doubt.

Senator KING. Mr. Hartson, are you ready to submit your report to the committee?

STATEMENT OF MR. N. T. HARTSON, SOLICITOR INTERNAL REVENUE BUREAU

Mr. HARTSON. The reason why this report, Senator, is submitted to-day is because it was not a very difficult one to prepare, in that only two controversies were involved, differing from some of these large corporations, and some of whose cases have dozens of points involved, all of them disputed, and all of them subject to conference and discussion.

The case of James Couzens, consisting of a revenue agent's report, covering the years 1916 to 1919, inclusive, submitted to this office—and "this office" refers to the bureau—under date of February 17, 1921, was taken up for audit in March, 1921.

The report showed additional taxes and overassessments as follows:

1916, no additional taxes; no overassessment.

1917, no additional taxes, but an overassessment of $188,711.25.

1918, an additional tax of $4,434.18; no overassessments.

1919, an additional tax of $2,147,204.17.

Senator KING. For that year or for the aggregate of those years?

Mr. HARTSON. For that year. It should not be understood that this is an additional tax, other than a proposed assessment. This is a revenue agent's report, but up to the status that I have read now there has been no assessment.

Senator KING. That was not the increase in the value of the property, but it was the tax per se.

Mr. HARTSON. That is the additional tax, which came about in the way that I will later explain.

The return for the year 1916 had previously been audited disclosing an overpayment of $45,290.17 resulting from the exclusion of stock dividends, amounting to $410,853.20, from the taxable income in accordance with the decision of the Supreme Court of the United States in the case of Eisner *v.* Macomber. It had been determined there that that amount had been erroneously assessed.

On March 15, 1921, before the audit of the case had been completed, the taxpayer submitted a brief to this office protesting the adjustments recommended in the report. The two main contentions of the taxpayer related to the year 1919, and were as follows:

It was contended that the charitable gifts of securities made by the taxpayer for which he claimed in his return a deduction of the fair market value of such securities, namely $1,796,994.74, should not have been reduced to the cost or market value on March 1, 1913, which was $436,050.92, or a decrease in the deduction of $1,360,943.82, on the ground that such action was contrary to the rules and regulations in force when the gifts were made.

That is the first contention.

The second contention is:

It was further contended that the dividends received by the taxpayer from the Ford Motor Co. on July 10, 1919, pursuant to the decree of the court of chancery in Dodge et al *v.* Ford Motor Co. (204 Michigan 465), did not constitute taxable income for 1919 inasmuch as the court below decreed that the amount should be paid on December 5, 1917 (which decree was affirmed by the State Supreme Court in 1919) from the 1916 accumulated reserve on hand August 1, 1916, and that the income was properly reported in an amended return for 1917 taxable at 1916 rates.

After the hearing on those two contentions was held in the unit, in the administrative branch of the bureau, and after the unit had determined that both contentions should be denied, the taxpayer took an appeal to the committee on appeals and review.

The committee on appeals and review heard this matter and denied both contentions that the taxpayer was making, and, in effect, sustained the revenue agent's report, which contains this proposed additional tax in the year 1919 of over $2,000,000.

The case was transmitted then to the unit, as is customary, for adjustment of the audit based on that finding by the committee.

In the meantime another taxpayer, whose case involved identically the same question—in fact, both questions were involved in this other taxpayer's case—had protested against the decision, the bureau's position. He protested against the bureau's regulations with regard to this gift. I will explain that a little later, but I just want to emphasize that at that time this other taxpayer had protested against the position that the bureau had taken with regard to the deductibility of gifts, the amount to be deducted for gifts.

The case was then submitted to the solicitor of the Internal Revenue Bureau for a further opinion on the question of the gift.

This question involved the proper basis for determining the amount of a deduction because of a charitable contribution of property; that is, whether the amount of the deduction should be based upon the value of the property at the time it was given or upon its March 1, 1913, value.

Mr. Couzens, in December, 1919, made charitable contributions of securities which had a fair market value at the time of $1,796,995.74. The fair market value of the property on March 1, 1913, was $436,050.72.

In making his return for the year 1919, Mr. Couzens claimed a deduction based upon the fair market value of the property at the time it was given, his action being in accordance with the provisions of article 8 of regulations 33 (revised), as well as in accordance with verbal advice given to taxpayer's representative, Mr. Spicer, by the assistant to the commissioner, J. H. Callan, on or about November 25, 1919, and also in accordance with a letter signed by Mr. Callan

under date of December 12, 1919, in the cases of Paul R. Gray and Philip H. Gray. The income tax unit, in auditing the return for the year 1919, allowed a deduction based only on the fair market value as of March 1, 1913, such action being in accordance with the provisions of article 51 of regulations 45, 1920 edition, as well as in accordance with an opinion rendered by the Solicitor of Internal Revenue, Carl A. Mapes, under date of October 19, 1922, in the cases of Paul R. Gray and Philip H. Gray, which involved precisely the same question.

Now, to explain those two apparently conflicting statements, it should be said that at the time the gift was made, Mr. Couzens inquired of the bureau as to how to treat the item, and the regulations at the time he made the gift permitted him to take the deduction in the amount of the value of the property at the date of the gift, and following those instructions the deduction was made in that amount, in excess of $1,000,000; that is, $1,700,000.

After the gift was made, the regulations were changed, and the regulations having changed, Mr. Couzens' returns by that time had come down for audit, and the changed regulations being in effect, permitting only the deduction in the amount of the value of the property as of March 1, 1913, that being the date the income tax law became effective, it made a substantial difference in the tax, of course.

So when I read, "The income tax unit, in auditing the return for the year 1919," I mean that it did that some time after 1919. It was 1921 when they came to audit it.

The regulations having in the meantime been changed, they allowed a deduction only of the fair value as of March 1, 1913, such action being in accordance with the regulations as they then existed.

The material provisions of the revenue acts of 1916, 1918 and 1921, are the same. See section 5 (a) (9) of the revenue act of 1916, as amended by section 1201 of the revenue act of 1917; section 214 (a) (11) of the revenue act of 1918; and section 214 (a) (11) of the revenue act of 1921. Those are the sections of the act, all of them being the same. There was no provision in the revenue act of 1913—that is an earlier act—or the act of 1916—that is earlier than the amended act—prior to its amendment by the revenue act of 1917, permitting the deduction of contributions made to charitable organizations. It was only in the amended 1916 act, or the 1917 act, that deductions for contributions to charitable organizations were permitted. The revenue act of 1917 was approved October 3, 1917. Article 8 (paragraph 92) of Regulations 33 (revised), promulgated January 2, 1918, provided as follows:

> Where the gift is other than money, the basis for calculation of value of the gift shall be the fair market value of the property the subject of gift at the time of the gift.

That is the regulation that was in effect at the time Senator Couzens made this charitable contribution.

The rule contained in Regulation 33 (revised) was apparently followed until February 4, 1920, when Treasury decision 2966 was promulgated. This Treasury decision changed the rule and laid down the rule that where the gift is other than money, the basis for calculation of the amount of the gift shall be the cost of the property, if acquired after February 28, 1913, or its fair market value as of

March 1, 1913, if acquired prior thereto, after deducting from such cost or value the amount, if any, which has been or which should have been set aside and deducted in the current year and previous years from the gross income on account of depreciation, and which has not been paid out in making good the depreciation sustained. In a memorandum to the Secretary, it is stated that the purpose of the Treasury decision was to amend the regulations in so far as it referred to gifts other than money so as to bring them into conformity with regulations covering other similar deductions in section 214 (a) of the revenue act of 1918, the bureau having held that in the case of deductions for losses allowed by section 214 (a), (4), (5), and (6) the losses must be based upon the cost or March 1, 1913, value.

It might be well to point out to you here that, under section 214 (a) of the act of 1918, certain deductions were allowed for certain items—losses, for instance, losses for destruction by fire of property, or other losses. The regulations at that time, and prior to 1918, had permitted the amount of the deduction to be taken because of the loss, and based that on the value of the property and the date it was acquired, if acquired subsequent to March 1, and on the March 1 value if acquired prior thereto; and this change in regard to charitable contributions, when made not in money, but in property, was made, so the files show, to bring this in line with the principle that had been followed with regard to other losses.

Senator COUZENS. Let me ask you right there: That is in spite of the fact that the law read otherwise?

Mr. HARTSON. No; the law does not state, Senator. The law merely permits the deduction; that is all. It does not show on what basis; it does not say how it shall be done; it merely permits the deduction to be made because of a charitable contribution. Now, it does not say whether it shall be in cash or property, or on what basis it shall be.

Senator COUZENS. Then what you read just awhile ago was a regulation of the bureau and not the statute?

Mr. HARTSON. The point I have in mind is this:

Section 214 (a) is the section of the law which permits these deductions to be made from gross income because of certain losses or contributions. Under the 1918 act and under the prior act, when the loss was a loss of property, the amount of the deduction should be based upon the value of the property as of March 1; but with contributions the amount of the deduction that might be taken when the contribution was not in money, but in property, was based upon the value of the property at the date that the contribution was made, and apparently there was a lack of harmony; at least, it was so felt by those in charge, and to bring it into line, to make the deduction the same, it being both under the same section, this change was made.

Senator COUZENS. Can you tell us just why the difference? I see the point, that there is quite a difference in the regulations.

Mr. HARTSON. Yes.

Senator COUZENS. Between the losses and charitable gifts. Can you explain just how that happened, that there should be such a difference in that?

Mr. HARTSON. No; I do not know that I can explain it.

Section 214 (a) is a comprehensive article or section in the law which covers all deductions which may be made from gross income, and, of course, deductions because of losses and deductions because of gifts, while there may not be any essential similarity in principle between the two, they both being deductions from gross income, they were included there.

Now, up until 1920, when this was changed, there had been a difference between the basis for taking the deduction between losses and gifts.

Under date of July 27, 1922, the solicitor addressed a memorandum to Deputy Commissioner Batson advising that a memorandum brief in support of a protest by Paul R. Gray and Philip H. Gray to the proposed assessment of additional income taxes for the years 1916 to 1919 involving a claim as to the basis of computing the amount of a deduction to be allowed in the case of gifts, had been submitted to his office and suggesting that such part of the file as might be useful in a determination of the question be transmitted to the solicitor's office. Under date of August 24, 1922, the files in the Gray cases were sent to the solicitor's office. At the request of Messrs. Goodenough, Voorhies, Long & Ryan, counsel for the taxpayers, a hearing was granted and set for September 9, 1922. Under date of September 6, 1922, a telegram was received from taxpayers' counsel requesting that the hearing be adjourned until October 5. The exact date when the hearing was finally held does not appear, but under date of October 19, 1922, a memorandum opinion was addressed to Deputy Commissioner Batson advising that accepting the provisions of T. D. 2998 as the correct interpretation of the applicable provisions of the revenue act of 1918, the liability should be determined on that basis.

Now, I want to interpose there this explanatory statement, that the reference to the solicitor's office in the Gray case was made not so much in contest of the fundamental principle of the correctness of this ruling, but was made on the basis that the ruling had been promulgated after the gift had been made and after the returns had been filed. Therefore, the taxpayers were taking the position that the change in the regulations should not have retroactive effect, so far as their returns were concerned, but should merely have prospective effect.

Senator KING. Are you not, by regulation, making retroactive the interpretation which you place upon the statute, so that the taxpayers would be compelled to pay under different assessments?

Mr. HARTSON. This opinion, Senator King, that the solicitor made, and which has been referred to here, held, roughly, that the interpretative regulations of the law, and which law remains the same and has not been changed, had to be uniformly applied, that there was no justification to interpret given language in the law one way for a certain period of time, and, without changing the language of the law, to interpret those rules differently from that date forth, and therefore held that this regulation, which had been changed in 1920, had to go back during all of the time that the law was in effect. In other words, the change was retroactive in its effect, because it was an interpretation.

I might say that the 1921 act which was not in effect at that time, and which has since been passed, contains a provisions which is not

refused to here, but which permits the commissioner, with the approval of the secretary, to promulgate regulations without retroactive effect, when that change is not brought about by a court decision or some change in the law.

Senator KING. If it will not be disturbing to the continuity of this matter, may I interpolate that yesterday I examined one of your promulgated volumes of regulations, more than 1,800, as I recall, some of them obviously containing interpretations at variance with former interpretations; some of them necessarily placing a construction upon the statute which would make it retroactive, the result of which would be to disturb accepted decisions taken in the department, and throw into chaos and confusion the tax returns of a large number of people.

Now, with that premise for corrective legislation—and the matter is before us in the Finance Committee now—do you not think that we have delegated too much authority to the commissioner and to the Secretary of the Treasury to promulgate regulations, and that they have promulgated too many regulations, many of which are contradictory, many of which the public never can become acquainted with, and many of which are so complicated, when applied to the statute, as that no taxpayer may ever know just what the tax against him is, unless he hires experts, and those experts, like all experts, will disagree. There are several questions involved in one there, but if you will explain that, either now or when you get through with that letter, I shall be very glad to have you do so.

Mr. HARTSON. I will be glad to discuss it and to answer any specific questions you desire to ask, Senator.

Senator KING. Perhaps you had better finish that, and then we will revert to it here.

Mr. HARTSON. The opinion, then, of the solicitor, which has been referred to here, merely held that those regulations which had been changed in 1920 had to be retroactive in their effect, even though, in some cases, gifts had been made pursuant to regulations which had theretofore been in effect and which were different from the ones at that time.

On that principle, as has been pointed out, you can not interpret the same language of the same law in two different ways; you can not do it both ways; you have to be consistent.

It should be noted in the memorandum opinion of October 19, 1922, the fundamental question of the correct basis of computing the amount of the contributions was not considered, but only the question whether in view of the change in the regulations the Government was precluded from figuring the liability on any basis other than that laid down in the regulations in force at the time when the gift was made.

The Couzens case first came to the solicitor's office in October, 1922. It did not come in connection with the assessment to be proposed in connection with the disallowance of the amount claimed as a deduction for charitable contributions, but came in connection with a certificate of overassessment for the year 1916. However, when the case was before the office counsel for the taxpayer appeared before the then solicitor, Mr. Mapes, who directed that the fundamental question relative to the deductibility of certain gifts should be gone into de novo and a hearing granted before the office conference com-

mittee. The hearing was set for December 12, 1922, but was adjourned at the request of Mr. Couzens' attorney, Mr. Arthur J. Lacey. The hearing was held some time in the early part of January, Mr. Hartson in the meantime having succeeded Mr. Mapes as solicitor.

I was appointed solicitor on the 1st of January, 1923.

At the request of counsel for Mr. Couzens a further time was afforded after the hearing for the submission of briefs which were not received until on or about the 1st of February. Under date of April 19, 1923, Law Opinion 1118 was submitted to the commissioner. This opinion reversed the then existing rule, and held that where a charitable contribution is other than money, the basis of the calculation of the amount for the purpose of the deduction allowed under section 214 (a) (11) of the revenue act of 1918 shall be the fair market value of the property at the time of the gift. In other words, we went back to where we had been in 1919. It appears to have been approved by the commissioner under date of May 1, 1923, and I might say that law opinions, under our custom, if not regulations, require the approval of the commissioner before they are effective. Under date of June 16, 1923, Secretary Mellon approved Treasury Decisions 3490 and 3491, which amended Regulations 45 and 62 to accord with the views expressed in Law Opinion 1118.

So law opinion 1118 discussed the fundamental principle as to what basis should be used when a taxpayer, having given property rather than money was permitted to make a deduction, what the amount of his deduction should be, whether it should be value at the date of gift or on the March 1 value. It was my view, and there was a difference of opinion in the office about it; I should say a dozen lawyers considered it in the office, and the majority of them were satisfied with this view. It was changed; the opinion expressed the contrary view, and regulations then were promulgated, signed by the commissioner, and approved by the Secretary.

Now, the opinion was published, and regulations are always published, beyond any question, and all taxpayers, of course, have had constructive notice, at least, of the change.

It should be noted that no additional assessment was ever made against Mr. Couzens in respect to the deduction claims by him on account of the gifts in question. Although an additional assessment was proposed, it was withheld pending further consideration of the question by the solicitor. In view of the fact that the position taken in Law Opinion 1118 was favorable to the taxpayer, the additional assessment was not made. Additional assessments on the gift proposition were actually made in the Gray cases, but the taxpayers filed abatement claims, and the commissioner instructed the collector that if in his opinion the collection of the tax would not be jeopardized he might delay collection pending further consideration of the question by the solicitor, so that the additional assessments were never actually paid by the Grays. If the gift made by Mr. Couzens had been allowed as a deduction on the basis of March 1, 1913, value, rather than on the value as of the date of gift, an additional tax of approximately $1,000,000 would have resulted.

There were only those two questions in your case—just two. Both of them were fundamental. They were questions that did not involve the Senator, particularly, any more than they involved a

great many other people. It was one of many questions of like character and of equal importance that the bureau is compelled to pass on and rule on day after day.

The law is not specific. Senator King has asked me whether or not too much authority has been given the Secretary and the Commissioner in making regulations. I think too much authority has not been given them. I do not see how it is possible to pass a law which is desirably simple and plain and clear on its face, and not give to the administrative officials the power to interpret the law and to settle the thousands of questions coming up in regard to one little item that is not specifically covered in the law. You can not go into the detail in enacting a revenue law which will anticipate and settle, beyond any question or controversy, the thousands of questions that are later going to arise. It simply can not be done.

Senator COUZENS. Could it not be written into that law that these deductions for losses and for charitable gifts should be based on the March 1, 1923, value, or on the basis of cost to the taxpayer, and not leave that question open for the interpretation of the Internal Revenue Department?

Mr. HARTSON. That certainly could be done, Senator, beyond any question.

Senator COUZENS. And in that case, it would have been wise, would it not?

Mr. HARTSON. I think it would have been wise.

Senator COUZENS. Yes.

Mr. HARTSON. Because I think it is most unfortunate that it has been necessary in this case or in any other case to change the regulation or change a ruling—most unfortunate.

Senator KING. Do you not think it is unwise to leave such a tremendous discretion in an executive department or administrative bureau as by the promulgation of a regulation which may increase the assessment a million dollars, or take from the taxpayer a million dollars, or a half million dollars, or any amount, for that matter?

Mr. HARTSON. I believe it would be wise to pass laws which would not require any interpretation, but I think, practically speaking, the Senator will agree with me that it is impossible. Our courts are filled with cases because of conflicting laws, but it seems that the more complicated cases and the more specific cases that are tried to be covered in the law, the greater the difficulty there is arising in their interpretation. I do not think you are ever going to eliminate the controverted points, or prevent their arising in these revenue laws.

This is a rather simple case; it is not a complicated situation, and it does not involve a tremendous amount of difference of opinion. The law does not say which way you shall do it, and it has been done several ways in the bureau. The first change, of course, as I say, was in regulation 33, and it was then changed in 1920. My recommendation is this law opinion was made in 1923, almost a year ago, and went back to the previous ruling.

Senator COUZENS. Do you not think the second ruling was more nearly correct than the first ruling?

Mr. HARTSON. I do not, under any circumstances. Do you mean the second ruling?

Senator COUZENS. Yes.

Mr. HARTSON. There have been three.

Senator COUZENS. Well, the second ruling, where you proposed an additional assessment to me.

Mr. HARTSON. I believe, as I have expressed myself in law opinion 1118, that the proper basis for taking deductions, when the charitable gift is other than money, should be the value of the property at the date of the gift, rather than at the date of the acquisition of the property.

Senator COUZENS. Well, I did not agree with your first interpretation of the law as I heard you read it now. I am not familiar with the case at all, except in a general way, but in effect it is that the taxpayer took credit in the charitable gift for an increment of value on which he had paid no income tax.

Mr. HARTSON. That is right.

Senator COUZENS. I do not justify that. In other words, if he were to take credit for an increment in his gift, then he should have paid income tax on the increment in his gift.

Mr. HARTSON. I am rather surprised, Senator, at your expressing yourself in that way, because it has been through the Senator's—through his accredited representatives'—opposition to that very principle which he now expresses that has given rise to this discussion in the bureau.

Senator COUZENS. As I say, I have not been at all familiar with the case. This is the first time that I have ever heard the details of the controversy.

Mr. HARTSON. I can well believe that.

Senator COUZENS. I never appeared before the bureau myself; I never wrote a letter myself to the bureau. I may have signed documents prepared by my attorney, but I never made a claim myself and never instigated the claim. It was all done in my office without any knowledge on my part as to what the real controversy was, except as I recall my attorney saying to me that it was an incorrect interpretation of the law, and not a difference in rulings of the bureau. Now, when my attorney presented it to me—I can not vouch for the absolute accuracy of it—I got the impression that you had interpreted the law, and not that you had changed your rulings.

Mr. HARTSON. Of course, most regulations were interpreting the law. They both involve an interpretation of the law.

Senator COUZENS. I understand that; yes.

Mr. HARTSON. But the interpretation found its way into the regulations, which were changed.

Senator COUZENS. Did you finally take the view, to put it in a concrete way, that if a man acquires a piece of property, say, worth a million dollars, and the accretion in value is $2,000,000; at the expiration of this date of accretion he gives it to some charitable institution and gets credit before the public, or otherwise, as a donor of property worth $2,000,000, that there is no income tax or no tax to be paid upon that million dollars accretion?

Mr. HARTSON. Senator, that is a fundamental question that involves the question of whether or not in law there is what we term a realization of profit, when it has been a gift. It is a piece of property acquired, as the Senator said, at an expenditure of $1,000,000, or it is worth that at the date he acquires it. He gives it away two or three years later, and it is worth $2,000,000. There has been that

appreciation of value. Has he realized a taxable profit when he gives it away and does not sell it?

Senator COUZENS. Certainly not, but he has realized a deduction which, in substance, is a realization of certain income; is not that correct?

Mr. HARTSON. Yes; that is correct. That, of course, is as near as anything can be correct. I am expressing my opinion.

I believe, as I have already said, that the deduction should be made, and the proper basis for taking the deduction when that gift is made is the value of the property at the time he gives it; that is, the date of the transaction. That is the time when, if he had sold it, he would have realized a profit. That is the time that the basis for the deduction, I believe, should be made, and I think that is the reasonable view to take of it, and I think a court would sustain that view.

Senator COUZENS. Has the bureau recommended in the new revenue act any change in that particular section, so as to make it more specific?

Mr. HARTSON. Senator, I do not know. It would be very readily determined, but I have not before me that information. I do not know.

Just one further word there, Senator. To permit the deduction to be made as of the date of acquisition or the March 1 date is an indirect tax upon that appreciation in value, which directly is not permitted, and I do not believe there is any justification for doing it indirectly.

Senator KING. What is your final ruling on that?

Mr. HARTSON. The final ruling now is expressed here in this law opinion 1118, that the deduction should be made based on the value of the property at the time of the gift, or the time he gives it, rather than at the time he acquires it.

Senator KING. You mean the deduction for the purpose of obtaining credit?

Mr. HARTSON. When the taxpayer computes his net income, he adds up all of his gross receipts, and he is permitted to take from his gross receipts certain deductions. One of the deductions that the law permits him to take is a deduction for charitable contributions, and there is a limit in the law. The law does not permit him to take a deduction beyond 15 per cent of his net income, computed without considering the charitable contribution; so that there is a limit on that deduction up to 15 per cent, and there was at the time that Senator Couzens made his contribution.

Senator KING. But you pay no capital tax there?

Mr. HARTSON. No.

Senator KING. For the transmuting or change in the property for the sale of it or the giving of it?

Mr. HARTSON. No; he pays no tax on it. The law specifically does not tax gifts.

Senator KING. Have you anything else you want to ask, Senator?

Senator COUZENS. I would like to ask if there was a special inquiry made within the bureau about a year or a year and a half ago, into the workings of the bureau by any one within the bureau?

Mr. HARTSON. I can only answer in a general way, Senator. I was not here at that time, but my information is that more than two years ago, but since the present administration has come into power,

an investigation was conducted there by Mr. Blair of conditions within the bureau. There were charges and countercharges made, and there were hearings conducted, and I think everybody who wanted to tell what they knew were permitted to come in and air their grievances, if they had any. I think it was a rather extensive hearing; but, as I said, that was before I came to Washington.

Senator COUZENS. Do you know who conducted that inquiry?

Mr. HARTSON. It was the commissioner's inquiry. Do you mean who——

Senator COUZENS. What individual?

Mr. HARTSON. Who appeared as the commissioner's representative cross-examining and questioning the witnesses?

Senator COUZENS. Yes.

Mr. HARTSON. My information is that it was Mr. Angevine, but that is by hearsay, as I say.

Senator COUZENS. You were not in the department at that time?

Mr. HARTSON. I was not.

Senator COUZENS. Was there a Mr. Marson in the department at that time?

Mr. HARTSON. I never heard of him. He may have been.

Senator COUZENS. Does Mr. Nash know anything about that inquiry?

Mr. NASH. Senator Couzens, I was in the department at that time, but not in Washington. I never heard of it.

Senator COUZENS. Was there a Mr. Matson there?

Senator KING. There was a Mr. Batson.

Mr. HARTSON. There was a deputy commissioner at that time by the name of Batson.

Senator COUZENS. Do you know whether or not there were stenographic notes taken of the hearing?

Mr. HARTSON. I do not know.

Senator COUZENS. You have not heard anything about those hearings since you have been in the bureau?

Mr. HARTSON. No; I have heard them referred to, Senator, but they have never been referred to officially, and I have no records on it.

Senator COUZENS. Will you ask the commissioner, for the committee, if he has any objection to letting us have the stenographic notes of that hearing?

Mr. HARTSON. I will be very glad to do so, and will report to you to-morrow.

Senator COUZENS. I would like to ask the engineer some questions at this point.

STATEMENT OF MR. S. M. GREENIDGE, HEAD ENGINEERING DIVISION, INTERNAL REVENUE BUREAU

Senator COUZENS. Do you know the history of the proceedings in the bureau with reference to depletion and amortization?

Mr. GREENIDGE. Yes; I think I do.

Senator COUZENS. How long have you been in the bureau?

Mr. GREENIDGE. About three years and a half, I should say, Senator.

Senator COUZENS. Have you dealt primarily with that question of depletion and amortization?

Mr. GREENIDGE. Primarily with questions of depletion, and during the last six months with amortization, I should say—about six months.

Senator COUZENS. In your dealings with these questions, were you guided by law, or were you guided by department rulings?

Mr. GREENIDGE. Fundamentally by the law, Senator, and, in addition thereto, by the regulations.

Senator COUZENS. Can you quote the law that guided you in your dealings with these questions?

Mr. GREENIDGE. Not verbatim, Senator, but I could refer to the sections of the law.

Mr. HARTSON. We have it all right here, Senator. It is very short.

Senator COUZENS. I think we had better have that read into the record. Let Mr. Greenidge have it, so that he can read it into the record, Mr. Hartson.

Senator KING. Yes.

Senator COUZENS. Let him read it.

Senator KING. Is that the law or the regulations?

Mr. HARTSON. It is both.

Mr. GREENIDGE. It is both.

Under deductions for depletion, section 214 (a) of the revenue act of 1921, states:

That in computing net income there shall be allowed as deductions:

In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within 30 days thereafter: *And provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the commissioner, with the approval of the secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *

The revenue act of 1921 goes on to deal with other deductions, but this is the section which we know as the depletion section.

Senator COUZENS. Since then has the department issued a large number of rules dealing with that question?

Mr. GREENIDGE. Yes, sir. I think I can tell you the number of them. I do not recall offhand.

Senator COUZENS. Well, let us forget the exact number, and say there was a large number.

Mr. GREENIDGE. Yes. I do not remember just how many.

Senator COUZENS. Has this large number of rulings changed the effect upon the taxpayer materially?

Mr. GREENIDGE. Yes, sir; to some extent.

Senator COUZENS. In other words, the variation in the rulings?

Mr. GREENIDGE. Yes; and in the law itself also.

Senator COUZENS. Well, you said the law.

Mr. GREENIDGE. Yes.

Senator COUZENS. We are dealing with the rulings that you made now, with the law as a basis.

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. And you have stated that there have been a great many rulings dealing with this question of depletion.

Senator KING. Those rulings you have found to be to the advantage of the taxpayer, have you not?

Mr. GREENIDGE. Well, judging from the way the taxpayer objects to their administration, Senator, I should say not.

Senator KING. But they have not resulted in very big reductions being allowed for depletion and cognate matters, which have relieved especially the oil men of millions of taxes, from the original assessment?

Mr. GREENIDGE. In excess of what would have been allowed if these regulations had not been written?

Senator KING. Yes.

Mr. GREENIDGE. I do not understand it that way.

Senator KING. You would say yes; is that right?

Mr. GREENIDGE. No, sir; I would not.

Senator KING. Well, do you say no?

Mr. GREENIDGE. Yes; because the law took cognizance of the fact that certain limits should now be placed, which in prior laws had not been placed. For instance, to explain just what I mean, the last part of that paragraph states that such depletion allowances shall not exceed the net income. That is the first time that that limitation appears in the act.

Senator COUZENS. I must admit that I am stupid if I do not understand why it is that you can allow more than that. You say that is the first limitation that is placed upon it for depletion. How could you allow more than the net income?

Mr. GREENIDGE. I would not accuse myself of being stupid in that particular respect, Senator Couzens, because the prior act did not place that limitation on it.

Senator COUZENS. I understand that, but how could you, without the act at all, have allowed more than the net income?

Mr. GREENIDGE. Well, the department never has, but the law itself never specified it.

Senator COUZENS. Even though the law did not specify it, how could you have allowed more than the net income? Under what circumstance could you have allowed more than the net income?

Mr. GREENIDGE. Well, if you got a depletion unit in excess of net income, it would have been allowable under the previous laws, because the previous laws did not specify the limit to which you could go.

Senator COUZENS. Yes; but I still do not understand how you could allow more to the taxpayer than his net income? What would you do? Give them some money in addition to that?

Mr. HARTSON. Treat it in subsequent years.

Senator KING. Treat it in subsequent years, and rob the Government by saving him an honest tax.

Senator COUZENS. Then, as I understand it, you said that the department at no time allowed more.

Mr. GREENIDGE. No. One very famous case has gone to the Court of Claims to be tested on that very point.

Senator COUZENS. You mean a public court?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. What is the name of that case?

Mr. GREENIDGE. The Texas & Pacific Coal & Oil Co.

Senator COUZENS. In that case you did not allow more than the net income?

Mr. GREENIDGE. No.

Senator COUZENS. And yet they are claiming more than the net income?

Mr. GREENIDGE. Yes; they are claiming even something in excess of the gross income. Now, in as much as that is a public case, of course, I feel that I can speak of it.

Senator COUZENS. Yes; I assumed in the first place that it was a public case.

Mr. GREENIDGE. Yes. As far as I am personally concerned, I have not any objection to discussing with the committee any matter that they feel that they have a right to ask in regard to.

Senator COUZENS. I understand that the Secretary has recommended in the new revenue act that the allowance for depletion be limited to one-half of the net income.

Mr. GREENIDGE. To 50 per cent, sir.

Senator COUZENS. How will that work in the cases of the large oil companies and the small companies, or will it act differently with the different companies?

Mr. GREENIDGE. I do not think that we have sufficient information at hand to answer that question in a definite manner, but the indications are that it will not act any differently as respects the large or small concerns; it will affect them both in greater or lesser degree depending upon the peculiar circumstances in each case.

Senator COUZENS. I got the impression, in talking with Colonel Drake, who discussed this question of depletion with me somewhat, that the Secretary hesitated somewhat about recommending that the depletion be limited to 50 per cent of the net income, because the large companies could well afford this change in the depletion limit, while some of the smaller companies could not afford such a ruling. I did not ask him any questions, but I do not see how it would affect one differently than the other.

Mr. GREENIDGE. I can not see that there is going to be a very material difference.

Senator COUZENS. It will bring in considerably more revenue to the Government, will it not?

Mr. GREENIDGE. Oh, undoubtedly.

Senator COUZENS. Has any estimate been made as to what additional revenue that will bring to the Government?

Mr. GREENIDGE. No, sir; we have not prepared any figures on that, and, to be perfectly honest with you, I think it would be a very difficult matter to prepare such figures. Of course, it will result in a material increase in revenue, however.

Senator COUZENS. In other words, that possible increase has not been computed in the Secretary's estimates of income for the year 1925?

Mr. GREENIDGE. No; I do not know whether they have done that or not. I have not seen that portion of it.

Senator KING. How do you operate in taking your depletion and in laying your tax against an oil owner? Just tell us the modus operandi. A man goes out and buys a section of land—I do not mean 640 acres, but a parcel of land——

Mr. GREENIDGE. Yes, sir.

Senator KING (continuing). In Beaumont or Taft or Coalinga, or any of the fields with which you are familiar, for $1,000, say. There may be oil fields contiguous, but none immediately adjoining. He sinks a well at a cost of from $20,000 to $45,000, and gets a gusher, yielding several thousand barrels per day, from which there is an enormous profit. How do you assess the tax for that year, and what factors enter into the ascertainment of the tax which shall be paid?

Mr. GREENIDGE. First of all, Senator King, he is entitled to the return of his cost, which, as you mentioned here, was about $1,000. He is entitled to that at the depletion rate; that is, at the rate at which his natural resource is exhausted. Now, when he drills a well, and he gets what is known as a discovery well, under the revenue act the value of that well is set up at the date that oil is discovered, or within 30 days thereafter, or as near thereabouts as possible. That is the discovey value.

Senator KING. You treat the value of the land as of that date in the market, regardless of the fact that he only paid $1,000 for it, do you not?

Mr. GREENIDGE. Yes, sir.

Senator KING. So that he gets that enormous subtraction from the tax; that is, he gets credit for that in ascertaining the tax?

Mr. GREENIDGE. Not from the tax, but he gets it as the deduction from gross income.

Senator KING. From the assessment on gross income?

Mr. GREENIDGE. Yes, sir; that conveys the same idea. Then, that discovery value is of course returnable to him at the rate at which his natural resource is exhausted annually.

Senator COUZENS. How do you arrive at the discovery value?

Mr. GREENIDGE. We take production of the well, and estimate therefrom as closely as possible by the production of a similar well, what its ultimate production of oil will be, and that is multiplied by the market price of oil as of the date of discovery, or within the 30-day limit. I had better first say that that market price of oil, multiplied by the probable production of that well, discounted to present worth over the estimated life of the well, becomes what is known as a capital sum returnable through depletion.

I would like to call the attention of the Senators to the fact that I use the words "capital sum," and not invested capital.

The capital sum is then divided by the number of units of oil that it is expected to be recovered from that tract, and each year, as he produces oil, the number of barrels that he produces, is multiplied by the depletion unit and the result is allowed as a deduction from gross income in the year in which the production has taken place.

Do I make myself clear as to that?

Senator KING. Yes; I understand it. I think that is the most ingenious scheme to rob the Government.

Senator COUZENS. In other words, Senator King, you believe that all he should get any depletion on is what he really put in the property: is that right?

Senator KING. Well, I would not put it that far, Senator, but, manifestly, if he pays $1,000 for a piece of property and spends $40,000 in a well, which yields, say, 5,000 barrels a day, he could sell that well on the market for—well, I do not know how much.

Mr. GREENIDGE. $100,000.

Senator KING. If that gave him 5,000 barrels, he could readily sell it from $1,000,000 to $5,000,000, and more nearly $5,000,000 than $1,000,000. Now, you would so manipulate that—and I do not use that term offensively——

Mr. GREENIDGE. Oh, no; I shall not take offense at anything you say, anyway.

Senator KING. So as to avoid paying taxes. Instead of taxing him upon his property or upon the value, you do not do that; you do not tax him; but suppose there were 5,000 barrels a day. That would be over 1,000,000 barrels a year, and supposing he sells that at 50 cents a barrel. You would tax him the amount of his profit that year, $500,000. You do not tax him upon the difference in value between the $1,000 which he paid, plus the $40,000 which it cost him to get the well, the cash value of the property, at which it could be sold under the hammer; but you introduce here all those elements to which you have referred and your partitions and divisions and the life of the property, of its productiveness, and you finally figure it down, so that he pays very little. That is the way it worked out, is it not?

Mr. GREENIDGE. I do not know what the oil companies pay in taxes, Senator King. My department does not deal in taxation. We deal in valuation.

Senator KING. But the application of that rule of assessments and deductions that you have just described would fritter away opportunities for taxation upon the increase in value of its productiveness for the year, would it not?

Mr. GREENIDGE. I would not want to answer that question offhand. I would like to ask you to state it over.

Senator KING. Well, what would the tax be that year? Suppose a well were discovered of a capacity of 5,000 barrels a day, and it was sold for 50 cents a barrel net to him, and that what he was out was the purchase price of $1,000 and the cost of the digging of the well, about $50,000, together with the necessary administrative costs.

Mr. GREENIDGE. Yes; what we call overhead.

Senator KING. Yes; overhead. How would you proceed to assess him for that year?

Mr. GREENIDGE. Well, he would be entitled, in addition to his overhead cost and lifting cost and charges for development, to his further deduction for depletion under the revenue act, as it is now written.

Senator KING. Yes. He paid $1,000, and you would deplete away not only $1,000 but the increase in value, would you not?

Mr. GREENIDGE. Yes; a part of the increased value, as shown by the procedure as outlined.

Senator KING. Now, I want somebody there to figure, on the basis of the case that I have just given, what tax he will pay that year.

Mr. GREENIDGE. We can do that, Senator, or at least we will furnish the valuation portion, and I have not the slightest doubt but what the auditors can figure it out.

Senator KING. In which section of the Internal Revenue Bureau are there typical cases of oil depletion and the method of computation which you have adopted, so that we can get hold of those files and examine into those cases?

Mr. GREENIDGE. My division, sir.

Mr. HARTSON. That would be some of these cases that the committee has already asked for?

Mr. GREENIDGE. Yes.

Mr. HARTSON. And the assessment method we will furnish the committee will reveal that very fact, Senator.

Mr. GREENIDGE. If there are other facts which would reveal anything more we will be glad to prepare them in such form as would be most understandable.

Senator KING. Well, until those cases are worked up, I will not encumber the record now by going further into that matter.

Senator COUZENS. Unless the officials from the bureau have something further that they would like to say, I am through now for the day.

STATEMENT OF MR. N. T. HARTSON, SOLICITOR, INTERNAL REVENUE BUREAU—Resumed

Senator KING. I want to ask you again, Mr. Hartson, the question that I suggested when you were reading that letter, which is, whether you do not think too much power has been delegated. You have answered it negatively to Senator Couzens. I called your attention a moment ago to a volume which I have in my office, and which I have examined, containing some 1,800 regulations. Many of those regulations have the force of penal statutes; many of them upon their face, seem incongruous with the law. Doubtless, they have been intended to make clear ambiguities in the statute. Many of your regulations, or at least some of them, overrule, not expressly, but by implication, anterior regulations. Those regulations, by the dotting of an "i" or the crossing of a "t" may change a man's assessment to his advantage or disadvantage to the extent of a million dollars or more. Now, do you think it is wise to commit such great power, which Congress should exercise as a legislative body, to an administrative bureau?

Mr. HARTSON. Senator, I am very sure that it would be very agreeable to all concerned in the administration of the revenue laws to be relieved of the responsibility of having to interpret the intention of Congress itself in regard to the revenue act.

I do believe, to answer your question specifically, that, as a practical matter, you can not; that is, Congress can not avoid the necessity for passing laws general in their effect. I do not believe you can make a law particularly applicable to every particular case that will be presented. Therefore, your law has to be more or less gen-

eral, and when you make it general, then you have to lodge in some administrative officer the duty of formulating regulations reasonable in their effect and in their interpretation of carrying into effect this law. I do not believe you can avoid it, but it would be highly desirable if you could do so.

Senator KING. It is obvious, however, if these regulations may be changed as they are, and those regulations affect property rights to the extent which you have indicated, it is an enormous power to lodge in an administrative bureau of the Government.

Mr. HARTSON. It is a tremendous power; yes, sir, but I do not see how it can be avoided. The human element is present, and mistakes in the administration of such a law as that are bound to occur, no matter who administers it.

Senator KING. Do you not believe that where you have such a great power, the utmost facility ought to be given to the taxpayer and freest opportunity afforded to him to present his case where you do make rulings that are conflicting with previous rulings, and where you claim an ambiguity in the statute and your ruling is adverse to that which has been accepted? Do you not think that there ought to be more opportunity to the taxpayer to complain and to rectify his wrong of which he complains, or at least have an opportunity to present his side of the case?

Mr. HARTSON. I believe he should be given every opportunity to present his case. I believe he is, under the present administratve procedure, given every opportunity. I believe that one grave reason why the bureau is behind in its work is this: If you will examine these particular cases that will be submitted, you will find one great cause for delay is the taxpayer's request and demand for additional hearings, for delays, so that they may present more evidence, and so that they may have further time for arguments and the filing of briefs, and weeks and months go by in the interim. I think the bureau is more than liberal in its present policy in affording the taxpayer every opportunity to make his showing.

Senator KING. Are you witnessing in the bureau greater celerity in the disposition of cases and greater efficiency in passing upon these questions, which are more or less complicated? Is there a higher standard of efficiency and ability shown now in the bureau in passing upon these questions?

Mr. HARTSON. I think that is true. I think there is. I think that is, to a large extent, caused by their increasing familiarity with and knowledge of the subject with which they are dealing. I think it is also true by reason of the fact that the taxpayers themselves are advised now of their rights, whereas, four or five years ago, during the war years, they did not know what their rights were, or did not know what the law was, and really the Government's representatives did not know.

Senator KING. Speaking generally, what do you say as to the honesty and integrity of those who pass upon these claims?

Mr. HARTSON. I think they are on a parity and I think equality with any other establishment that is comparable to it in size. I think that, generally speaking, the men and women who work in the Internal Revenue Bureau are honest, earnest, and conscientious, and are attempting to do the right thing. I think they have a most difficult job to perform.

Senator KING. Representations have been made to me frequently during the past two or three years by people within the department, as well as those outside of the department, that favoritism has been shown in promotions and in the assignment to positions where these cases of importance are to be handled. What have you to say as to those charges or statements?

Mr. HARTSON. I think you can hear anything any time about any subject which you care to listen to. I think, if you should go to the Ford Motor Co. or the Standard Oil Co. of Indiana, or the United States Steel Corporation or any corporation that employs as many people as are employed in the bureau, you will find just as many charges by employees in such an organization of favoritism or discrimination, and of failure on the part of those who are in control to recognize the ability of those who are in the ranks. I think that situation does exist in the bureau. I know of no place where it does not exist. You will find it in every department of the Government and in every similar business establishment. You can not get 100 per cent loyalty and cooperation out of everybody, certainly.

Senator KING. You have been in the bureau for a year and a half?

Mr. HARTSON. Going on two years—a little over a year and a half.

Senator KING. What position did you take when you entered the service there?

Mr. HARTSON. I came into the department as assistant solicitor of internal revenue.

Senator KING. Then you became solicitor by succeeding Mr. Mapes?

Mr. HARTSON. That is correct.

Senator KING. Did Mr. Mapes or Mr. Wayne Johnson or their friends have anything to do with your appointment?

Mr. HARTSON. I do not think they did. Mr. Mapes was my superior officer, and I serving under him, I hope he had cause to commend me to the commissioner. My appointment was made by the President, based upon the recommendation of the Secretary of the Treasury and the Attorney General. I was serving under Mr. Mapes, who was my superior. I do not know whether he went to the commissioner, or the commissioner called upon him for a recommendation, but I would naturally suppose so.

As far as Mr. Johnson is concerned, as far as I know I do not think that he had anything to do with it. I am positive he did not have.

Senator KING. Of course, you are well acquainted with Mr. Mapes and his partners in his law firm?

Mr. HARTSON. I have met both of them. I knew nothing of them before I came to Washington, but I have seen Mr. Mapes constantly during my service in the office under him. I saw him a great deal. I had occasion to advise with him and consulted with him constantly on office problems. I met Mr. Johnson. Mr. Johnson was a man who occasionally had cases in the office.

Senator KING. Their firm has a good many cases in the office, does it not?

Mr. HARTSON. Yes; their firm has cases in the office. I know other firms that have more, but their firm has a good many.

Senator KING. And Mr. Johnson went from the department to New York and entered into the collection of taxes or into the tax business?

Mr. HARTSON. He formed a law partnership in New York, and among the other business that they had I think he engaged in tax practice.

Senator KING. Mr. Mapes resigned and went to New York and entered his office.

Mr. HARTSON. I do not know what Mr. Mapes's arrangement is. Mr. Mapes has an office in Washington, in the American National Bank Building, and has been practicing there for over a year.

Senator KING. And is he not connected with that firm?

Mr. HARTSON. I do not know that he is.

Senator KING. And Mr. Angevine is likewise?

Mr. HARTSON. Mr. Angevine is associated with Mr. Johnson in the firm in New York.

Senator KING. And he was in the office?

Mr. HARTSON. He was in the office.

Senator KING. Do you know any others who are in that firm and who were in the office?

Mr. HARTSON. Yes; Mr. Alverson, who was formerly in the Solicitor's Office, is now associated with Mr. Johnson in New York.

Senator KING. Any others?

Mr. HARTSON. I think not connected with the firm. I think they have an employee who was formerly employed in the office down there.

Senator KING. Is there anybody with Mr. Mapes here, who was in the office there?

Mr. HARTSON. So far as I know, Mr. Mapes has no one associated with him down here.

Senator KING. Who selects the so-called court of appeals that you have—the board of review and appeals?

Mr. HARTSON. It is the committee on appeals and review.

Senator KING. Yes.

Mr. HARTSON. That is an organization, a committee selected by the commissioner and the Secretary. It is directly under the commissioner's control.

Senator KING. A number of people have been assigned to that work who are wholly unfamiliar with tax cases, have there not?

Mr. HARTSON. I think not. So far as I know, there is only one man on the committee now who was not formerly connected with the bureau. That is the only one that occurs to me. All of the others are there as the result of promotions within the organization. There may be one or two. There is a lawyer from Boston who is on the committee—a very excellent lawyer, who, I think, had no experience within the bureau before he was appointed there, but he was a man who was very familiar with tax questions.

Senator KING. Did you have anything to do with the formulation of that provision in the pending revenue bill which provides for a court of 27 members?

Mr. HARTSON. I did not.

Senator KING. From your experience in the department, would you venture to give your opinion as to the wisest way of handling these appeals?

Mr. HARTSON. I think that the conditions should be borne in mind. Under the present bill, appeals are permitted, to be taken before an assessment is made, to this board of appeals in every case. There is no distinction as between one case and another. The appeal lies in every case. The practice and experience down there has shown that in a very large percentage of the cases where an additional tax is proposed to be assessed, an appeal is taken. The taxpayers when aggrieved with the decision of the unit, avail themselves of their right of appeal.

The present committee which hears these appeals prior to assessment is now composed of approximately 20 men. There are approximately a thousand cases; they are a little in excess of that, maybe 1,200 cases, that are pending now before the committee. There is an accumulation of that number of cases, and those men are working night and day. They hear appeals individually, and the chairman passes upon them in review before they go out. They hear two and sometimes three cases a day apiece. Their production record is around 100 cases a week, and they are a thousand cases or more behind. All of that work is done without swearing the witnesses, without having a Government representative before them, and without conducting their proceedings as a court would conduct them.

Now, take the board of appeals. The board of appeals gives to the taxpayer the right of appearing by counsel. The commissioner may also appear. I assume that the solicitor, or his office, might well appear in some cases before the committee, and act as advocate for the Government before this board. A record is made. It is taken down, I assume, or ought to be. The witnesses are sworn, and they may subpœna witnesses from anywhere in the United States.

Such procedure, while highly desirable from the standpoint of protecting the rights of the taxpayer and relieving the present officials of the bureau from the tremendous responsibility which they have, necessarily slows up the work to a point where it may be, as a practical matter, undesirable.

A court can not dispose of a case as expeditiously as an administrative officer can, who is quasi judicial in his functions; and, unfortunate as it may be, one of the greatest problems that the bureau has had from the beginning has been production. It has been trying to get these cases settled, and if, prior to assessment, the taxpayer may have his right of going in before a court and arguing his case and letting the Government argue its case, submitting authorities and submitting briefs, and have that tribunal pass on it as a court would pass on it, you will have this tremendous volume, and chocked up there to the point where it may be, as an administrative matter—it may be as a question of congressional policy—that it would seem undesirable to do that.

Senator KING. Your idea would be, then, to obtain the best administrative officers that you can, and give them a good deal of authority to right an appeal there, and from which the Government or the taxpayer can go to the courts, as the last resort, if either the Government or the taxpayer desires it.

Mr. HARTSON. I do not want to be understood as being opposed to the court of appeals. I think it is highly desirable. I think it would be a most excellent thing, but I am not one from the outside

looking at the theoretical result. I am one who is on the inside, overburdened with work, with too few employees, with too great responsibility, and I do not see how, with a tribunal such as this is supposed to be, they could get these cases settled and get them out of the way, in the way that has been planned or hoped for by this board.

Senator KING. Has any alternative plan been prepared or suggested by the commissioner or by your office?

Mr. HARTSON. No; I do not know that there ever has been. My office, as far as I know, has never been consulted with regard to it.

Senator KING. Well, this plan seems to me to be cumbersome, and it had its birth in somebody's brain. Now, who is the father of it?

Mr. HARTSON. I do not know.

Senator KING. It did not come from your department?

Mr. HARTSON. It did not come from my office; no.

Revenues, from the beginning of our Government, our courts have said, have to be raised. It is a matter of primary importance that the Government get the money, in order to sustain itself, and they have lodged in an administrative officer, and the courts have sustained the right to do that; they have sustained the propriety of doing so, of placing in an administrative officer the responsibility of making the determination. After he has made that determination, he is bound to collect the money on that basis. The Supreme Court of the United States has recognized that is harsh, that to require a taxpayer to pay money before he can litigate in a court of law is arbitrary and severe. It imposes a hardship upon taxpayers that is devastating in some cases; but they have sustained it, because it was conceived to be of the utmost necessity that the Government should get the money first, in order to perpetuate itself.

Senator KING. Oh, yes; the power of taxation is a harsh power.

Mr. HARTSON. Now, you are injecting prior to assessment, this trial at law, or court procedure, which may, as I say, from an administrative standpoint, have its defects. You have asked my opinion and I have tried to express it. I have not expressed it in any other way than my own personal views in regard to it.

Senator KING. The subcommittee is charged with the duty of making recommendations to the full Committee on Finance, having under consideration the present bill, any suggestions or corrective legislation which may deem proper, and one of the things that we are very much interested in is this question of passing upon controversies over assessments. I shall take the liberty of asking your department, if you feel that you can express yourselves freely, though you may run counter to the Secretary of the Treasury, to recommend a plan which you think would be most efficacious, doing justice to the taxpayer and justice to the Government, and, of course, with expedition and celerity.

One of the evils of the plan which is in the bill, as I see it, is that it makes for congestion. While it will, perhaps give the taxpayer a fuller opportunity, it seems to me you will cumber the records with appeals and hearings until you will never finish your work of collections. I am not satisfied with it. I have not a concrete recommendation to make yet, and if you could make a recommendation, I am sure that the subcommittee would be very glad to have it.

Mr. HARTSON. Yes; I shall be glad to——

Senator KING. Based upon your experience there and upon the operation of the department in collecting taxes and the difficulties that would be encountered.

Mr. HARTSON. If the committee should desire us to make any inquiries or ask any questions, my only request would be that it should be submitted to the Secretary of the Treasury, so that any correspondence of the department, which would be referred to me by the Secretary, would be something that had his full knowledge.

Senator KING. Of course, that shall be done.

Mr. HARTSON. I have not the slightest doubt in the world that the Secretary would be glad to have me express my opinion in any way I care to.

Senator KING. I shall ask Senator Watson to address a letter to the Secretary, asking that you be requested, in view of your experience there and your intimate acquaintance with the operations of the bureau, to submit, for the benefit of the committee, your views as to what legislation is needed in dealing with these questions.

Mr. HARTSON. Very well.

Senator KING. I have nothing else, Senator.

Senator COUZENS. I would like to ask Mr. Hartson if he has looked up any of those memoranda that I read into the record yesterday?

Mr. HARTSON. I do not know what the Senator has reference to.

Senator COUZENS. You will remember those bureau records that I read in yesterday, from the Standard Steel Car Co. Have you looked yp any of those?

Mr. HARTSON. I have not. I have not looked them up, Senator, but in those cases, which are to be submitted to the committee, you will undoubtedly find that in the files.

Senator COUZENS. The originals?

Mr. HARTSON. The originals; yes.

Senator COUZENS. Did you look up the matter to see if you knew any of these men who are still in the bureau; the names of these men that were mentioned?

Mr. HARTSON. No; I do not know that I did. Offhand, I might remember them. The bureau is a very large place. Some of those may not be in my office, but down in the units.

Mr. NASH. Senator Couzens, if you are referring to Culley and Kishpaugh——

Senator COUZENS. I know Culley is gone, but how about Kishpaugh?

Mr. NASH. Kishpaugh resigned last September.

Senator COUZENS. Do you know where he went?

Mr. NASH. I understand that he is in Philadelphia, but I have not verified that.

Senator COUZENS. Is Mr. B. L. Wheeler, chief of engineers, there?

Mr. NASH. Mr. who?

Senator COUZENS. Mr. Wheeler.

Mr. NASH. No; Mr. Wheeler has resigned from the department. I think he resigned in March, 1922.

Senator COUZENS. Is Mr. Diemer still there?

Mr. NASH. I do not know.

Senator COUZENS. I understood that Mr. de La Mata had gone?

Mr. NASH. Mr. de la Mata resigned last fall.

Senator KING. Are any of those men practicing before the bureau?

Mr. NASH. I have heard of Mr. de la Mata practicing, but I am not sure about that.

Senator COUZENS. The committee would like the records of the Standard Steel Car Co. and the Aluminum Co. of America, mentioned in the Secretary's letter to the chairman of the committee, dated March 25, 1924. We will not deal with the Gulf Refining Co. at this time, because that matter has been arranged previously.

Senator KING. The committee stands adjourned.

(Whereupon, at 4 o'clock p. m. the committee adjourned until to-morrow, Wednesday, March 26, 1924, at 2 o'clock p. m.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

WEDNESDAY, MARCH 26, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE,
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met, pursuant to adjournment, at 2 o'clock p. m., Senator James E. Watson presiding.

Present: Senators Watson (chairman), King, and Couzens.

Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. J. G. Bright, deputy commissioner, Income Tax Unit; Mr. N. T. Hartson, Solicitor Internal Revenue Bureau; and Mr. S. M. Greenidge, chief, engineering section, Internal Revenue Bureau; and Dr. T. S. Adams, tax expert, Yale University.

The CHAIRMAN. The committee will be in order.

Senator COUZENS. I would like to have Mr. George O. May take the stand.

STATEMENT OF MR. GEORGE O. MAY, SOUTHPORT, CONN., MEMBER OF THE FIRM OF PRICE, WATERHOUSE & CO.

Senator COUZENS. Give your address, please, and your occupation, Mr. May.

Mr. MAY. My business address is Southport, Conn. My business is public accountant.

Senator COUZENS. I think, Mr. May, in view of the fact that your name was suggested by Doctor Adams as knowing considerable about the workings of the Internal Revenue Bureau, perhaps it would serve the committee best if you started right in and told us in your own way your story of your experiences and observations in the Internal Revenue Bureau, during which you may cover a number of the matters that I want to ask you about. If that is agreeable to you, I would like to have you proceed along those lines.

The CHAIRMAN. May I ask a question or two first?

Were you ever connected with the Internal Revenue Bureau?

Mr. MAY. No.

The CHAIRMAN. You never were?

Mr. MAY. I was in the Treasury during the war, but not in the Internal Revenue Bureau.

The CHAIRMAN. How long were you in that department, Mr. May?

Mr. MAY. About 18 months.

The CHAIRMAN. And what position did you occupy?

Mr. MAY. I was in the war loans, foreign and allied government loans, and I subsequently represented the Treasury on the War Trade Board.

The CHAIRMAN. Were you at any time brought into contact with the workings of the Internal Revenue Bureau during your occupancy of that position there?

Mr. MAY. Only very slightly.

The CHAIRMAN. Just occasionally?

Mr. MAY. I was advising the Secretary and the Assistant Secretary on some questions of policy, and occasionally I had to make inquiries in that connection.

The CHAIRMAN. You are now a public accountant?

Mr. MAY. Yes. I am senior partner of Price, Waterhouse & Co.

The CHAIRMAN. How long have you been such?

Mr. MAY. I have been a public accountant all of my business life.

The CHAIRMAN. Yes.

Mr. MAY. I have been a partner in Price, Waterhouse & Co. for 22 years.

The CHAIRMAN. You may now proceed to answer the question asked by Senator Couzens.

Mr. MAY. Well, I do not know whether I am quite qualified to talk just along the lines that you suggest, Senator, because, personally, I have not had any very intimate contact with the Internal Revenue Bureau in the matters of detail. I have had personal connection with comparatively few of the tax cases handled by my office. They were only some of the most important that I have dealt with personally; but by reason of my former association with the Treasury I have taken a keen interest in it, and have followed its workings, and have discussed it from time to time with the secretaries for the time being and the commissioners for the time being. I have a certain general knowledge in that way.

The CHAIRMAN. Yes.

Mr. MAY. It is a very large subject, and I think it would be better if somebody would indicate the lines on which they would like me to talk and what phases they want to develop. Perhaps it would be more effective if you would do it in that way.

The CHAIRMAN. Possibly Doctor Adams can lead you. He is familiar with it.

Senator COUZENS. I have no objection to that, and I will ask my questions later.

The CHAIRMAN. Go ahead, Professor Adams.

Doctor ADAMS. I was merely going to suggest that Mr. May, who has had relations with a large number of the most important corporations in the country give us his experience with respect to solicitations, and whether, in that connection, he has known of these concerns having been approached by people who wanted to handle their tax cases, if that is agreeable to you.

Senator COUZENS. Yes; that is agreeable to me.

Mr. MAY. I think, according to reports reaching me from the people I meet, that in the cases of larger corporations it is practically a universal condition. From my experience, I should say that almost every executive of an important company has been approached many time by someone claiming a special ability to deal with tax cases.

Senator COUZENS. We have had no taxpayers here as yet as witnesses. We have not gotten that far, but it seems to me in view of what Professor Adams has said, you might give us a general idea. You say it is the experience of every executive, or nearly every execu-

tive of these big corporations, that they have been approached by so-called tax experts, who have told them that they could get their taxes refunded or adjusted, or their claims allowed, or something of that sort. Will you tell us what your experience has been in that connection?

Mr. MAY. A large number of my clients from time to time have told me of such calls. I do not know whether you want me to mention names. It is hardly a case which can be covered by mentioning names; it is so universal, I should say; but the most significant feature about it, to my mind, as far as my own personal experience goes, is the very large percentage that have rejected all such overtures and have decided to handle their tax matters either through their regular counsel or their regular accountants.

Senator COUZENS. Have those individuals who have solicited these big corporations been, in most cases, former employees of the bureau?

Doctor ADAMS. A very substantial proportion of them; yes.

Senator COUZENS. The committee might like, Mr. Chairman, to pass on the history of some of these cases, so that we can subpœna some of these taxpayers who have been approached and learn what propositions were made to them. Therefore, if it is agreeable to Mr. May, he might give us as he goes along a few of the names of the corporations that were approached in this manner.

Mr. MAY. Well, it is easy enough to name them on the basis of just general conversations. I have very little specific information in regard to them: but if you take all of the important corporations I suppose every important steel company, for instance, such as the United States Steel, the Youngstown Sheet & Tube Co., the Inland Tube & Steel Co., the Bethlehem Steel Co.—all of them have told me of being approached; but all of those corporations, I think, are continuing to be represented by their own counsel and their own accountants.

The CHAIRMAN. Can you give us the name of any one man who formerly had been in the employ of the Internal Revenue Bureau, who, after getting out, approached one of these large corporations and asked to represent that particular corporation in a tax matter before the bureau and what the terms proposed were?

Mr. MAY. If I could recall such cases, it would only be second-hand information.

The CHAIRMAN. Yes; it would be hearsay.

Mr. MAY. It would be hearsay.

The CHAIRMAN. Yes.

Mr. MAY. As a matter of fact, it has been so common that it left no impression on my mind. I could, from hearsay, tell you one or two specific cases that happened, and which I have in my mind, and which I have every reason to believe are accurate. If you care to have hearsay testimony, I could give you the names of one or two corporation officials who have told me of such cases; but, generally speaking, of course, I do not care to mention the names of clients on hearsay, unless the committee presses me for them. If you want some specific names, of course——

Senator COUZENS. I think we ought to have them, so that we can get their views as to the workings of the bureau and what experience they have had with the bureau. As I say, we have had no taxpayers here yet as witnesses.

Mr. MAY. Well, I might give you one or two representative cases, and then, if I might, I would suggest that probably some general form of questionnaire be addressed to a number of representative corporations, and that would give you a much better cross section than you would get by taking a chance on what one particular witness might be able to tell you.

The comptroller of the Remington Typewriter Co.—that being one specific case—told me that he had been approached by several people.

The CHAIRMAN. What is his name?

Mr. MAY. C. H. Ashdown. The most conspicuous case that he had was a man that gave him, before they received the proposed assessment, what he understood they would receive.

The CHAIRMAN. Who was that man, Mr. May?

Mr. MAY. I do not know the name of the man, but you could get that from him. I called him up on the telephone yesterday and asked him about it and he said he was not quite sure, that it was one of two men, and he would have to look up his records. I would rather not mention any name, unless I was sure of it.

The CHAIRMAN. Do you know whether either one of those two men that he had in mind had been employed previously in the bureau?

Mr. MAY. He understood so.

The CHAIRMAN. Yes.

Mr. MAY. But the significant fact in that case was—and I suppose this was two years or two years and a half ago—that the man gave him an exact figure, which finally appeared in the assessment levy. I believe it was absolutely accurate, and this man said that he would be willing to handle it on a 10 per cent contingent fee. As I recall the amount involved, it was about $800,000. They declined that and all similar offers, and my firm handled the matter with the bureau, and, without any serious difficulty, we got it adjusted. The amount of the additional tax was relatively small—certainly less than $50,000, as I recall it, instead of $800,000. Our charge, I imagine, was somewhere around $5,000.

Senator COUZENS. In other words, had the comptroller of the Remington Typewriter Co. accepted this supposedly former employee's proposition, he would have gotten $80,000?

Mr. MAY. Yes; or $75,000, or something of that sort.

Senator COUZENS. That is a good example, I think, of the kind of cases we want. Can you give us some more?

Mr. MAY. Well, I just want to give typical cases.

Senator COUZENS. Yes.

Mr. MAY. And when I say "typical," I do not mean to say that they are typical of the general run of events, but different types of cases. What I would like to impress upon you all the time is that my knowledge is just fortuitous of these facts, and I can not say whether any particular practice is just an exceptional case or a representative case. I would not like to have too broad deductions drawn, without getting a broader cross section than I can possibly give you.

The CHAIRMAN. Of course, the only cases in which this committee is interested in reality, so far as anything remedial is concerned, are those where former employees of the bureau have gone out to make

these solicitations, the idea being that they either had knowledge of the situation before they went out, of which they took advantage, or, having gone out, they still had a connection in the bureau through which they ascertained this information.

Mr. MAY. Yes.

The CHAIRMAN. And not the cases of purely outside men who had never had anything to do with the bureau.

Mr. MAY. In this case, there was evidently some contact with the bureau, from the fact that he was able to recite the precise amount of the assessment.

The CHAIRMAN. Yes.

Mr. MAY. I have heard of one or two cases of agents who were on the examinations recommending the taxpayer to employ particular people.

The CHAIRMAN. That is a good thing to put in the record, if you can give those names personally.

Mr. MAY. The only case that I would feel justified in mentioning the name is a case in the courts on suit. The man to whom the remark was made made an affidavit on the subject, which I have seen, so I think that is sufficiently definite to be justified, although it is more or less second hand.

The CHAIRMAN. I say, who is the man?

Mr. MAY. The agent's name in that case was Kennedy.

The CHAIRMAN. Kennedy?

Mr. MAY. Yes.

Senator KING. Was he in the service?

Mr. MAY. He was assisting the agent in charge. He was the second man in the investigation of the company.

The CHAIRMAN. And what was that company?

Mr. MAY. That company was the West Virginia Pulp & Paper Co.

The CHAIRMAN. And this man that was assisting the agent said to this gentleman that they ought to get a certain man to help them?

Mr. MAY. Yes.

The CHAIRMAN. Now, whom did he recommend?

Mr. MAY. I would rather hesitate about that, because——

The CHAIRMAN. Well, was that stated in this affidavit?

Mr. MAY. Yes, sir; it is in the affidavit, but at the same time——

The CHAIRMAN. Who had the affidavit, Mr. May?

Mr. MAY. The affidavit was not used at all.

The CHAIRMAN. I know, but who had it when you saw it?

Mr. MAY. It was in my office. We have an executed copy of it in our office.

The CHAIRMAN. Of the affidavit?

Mr. MAY. Of the affidavit; yes, sir.

The CHAIRMAN. Who made the affidavit?

Mr. MAY. The man who was approached—a man named Condit, the cashier of the company.

The CHAIRMAN. Of the West Virginia Pulp & Paper Co.?

Mr. MAY. Yes.

The CHAIRMAN. How did he happen to make that affidavit?

Mr. MAY. The case was dragging in the bureau, and the question was considered whether it was desirable to take it up with the commissioner personally and suggest the fact that they had not retained that particular person, which was responsible for the delay.

The CHAIRMAN. That is what I want to get at. This man Kennedy had spoken to Mr. Condit about it. Did they then employ the man that he recommended?

Mr. MAY. No.

The CHAIRMAN. They did not?

Mr. MAY. They went on with their regular counsel and ourselves, who were the accountants for the company.

The CHAIRMAN. Well, was it afterwards settled without their having employed this person?

Mr. MAY. Oh, yes.

The CHAIRMAN. They never did employ that man?

Mr. MAY. They never did employ him.

The CHAIRMAN. But the affidavit was made because, when the case dragged along, they thought it might have some relation to the fact that they had not employed the man who was recommended?

Mr. MAY. That is right. Finally, we decided not to take any action and to have a little more patience; so the affidavit was never used.

The CHAIRMAN. Who was the regular attorney?

Mr. MAY. He is in the employ of the company. He is counsel within the office, and not an outside practicing attorney.

The CHAIRMAN. You were not connected with them?

Mr. MAY. Oh, yes; we were the accountants.

The CHAIRMAN. Oh, you were the accountants?

Mr. MAY. Yes, sir; we handled the case principally before the bureau.

The CHAIRMAN. Now, when you handle a case as an accountant, that does not make you the attorney, does it?

Mr. MAY. Frequently we hold power of attorney from a corporation. We act as agent of the corporation in practicing before the bureau; if the questions are mainly accounting, the power of attorney runs to us, and we conduct the case, in consultation with counsel. If the questions involved are mainly legal, the power of attorney runs to the counsel, and we advise them on the accounting phases of it.

Senator KING. You do not pretend to be lawyers?

Mr. MAY. Oh, no.

Senator KING. And you do not represent yourselves as lawyers?

Mr. MAY. Oh, no.

Senator KING. Do you solicit business as lawyers?

Mr. MAY. We do not solicit business in any capacity.

The CHAIRMAN. I was going to ask Mr. May that question.

Senator COUZENS. I was wondering just what your objection is to telling the name that appeared in that affidavit.

Mr. MAY. My only reason for doing it is that I have no means of connecting the agent with the man named. I would not like to do it publicly, and would prefer to give it privately to the committee, because I do not like to have a man's name mentioned, and possibly have aspersions cast on him, when there was nothing to show that he was in collusion with the man who made the suggestion, but is just being based on general knowledge. That is my only reason.

Senator COUZENS. In other words, you would be willing to give us his name so that we may subpoena him, if necessary?

Mr. MAY. If you think desirable.

Senator KING. Have you heard of this man Kennedy recommending this same person to other people?

Mr. MAY. No.

Senator KING. Do you know whether this person so recommended by Kennedy had been in the department?

Mr. MAY. I think not.

Senator KING. Did he give any reasons for recommending this man?

Mr. MAY. He simply said, "There is going to be a very large additional assessment." The proposed assessment was very large, but the element of the additional tax was relatively small, only a fraction of the amount proposed. Ne said, "There is going to be a bigger tax assessed, and you want to get the best man you can."

Senator KING. Then, solicitation was made before the assessment?

Mr. MAY. Before the assessment letter had been written.

Senator KING. Yes; and the first knowledge that these people had of it, so far as you know, came from this man, and not from the letter?

Mr. MAY. Well, he was working the job; they knew that there would be an additional assessment.

Senator KING. And they had understood that?

Mr. MAY. Oh, yes; and the only question was how much it would be.

Senator KING. Was there any basis for an additional assessment?

Mr. MAY. Oh, yes; there were some very arguable points. The original A-2 letter, as it is called, called for a much larger assessment than could have been warranted on any real basis, but I should not say that it was a purely fictitious assessment, at any stage. There were some very arguable points. In fact, there was one of the points that the bureau decided against the company that will probably go into the courts. So it was not just a made-up assessment for the sake of being knocked down.

Senator KING. Did Mr. Kennedy represent that he believed that the proposed assessment was just and fair?

Mr. MAY. He was only the assistant of the agent in charge of the examination. He was not the man actually in charge.

Senator KING. Was the agent in charge located here in Washington, in the department?

Mr. MAY. I think he was sent from Washington; yes. But there was no suggestion that he was connected with it in any way. He never did anything that was open to criticism.

Senator KING. Did he finally make the assessment as large as that indicated by Mr. Kennedy?

Mr. MAY. Kennedy did not say. As I remember, the proposed additional assessment was somewhere between $2,000,000 and $3,000,000.

Senator KING. What assessment was finally made?

Mr. MAY. I think somewhere around $600,000. It was largely a doubtful question, and it probably will be litigated.

Senator KING. That is all I have to ask at this point.

Mr. HARTSON. Mr. Chairman, I think it proper to inform the committee that this West Virginia Pulp & Paper Co. that Mr. May is now testifying about, has been the subject of a very thorough investigation on the part of the bureau, and I am sure the commis-

sioner would have no objection to submitting the record of his investigation in this case to the committee.

Mr. MAY. The only criticism we have ever had in regard to it was the delay. The ultimate disposition of it, I think, was entirely fair, I do not personally agree, naturally, with the decision on one major point, but I think it was an entirely arguable point, and I am inclined to think if I had been a Government officer I would have done as the Government did, and I would have said, "This is a case where we must put you to the test of the courts." I think that is an entirely reasonable attitude. I have no criticism of it.

Senator COUZENS. In reference to this case being investigated, did you investigate these Kennedy charges?

Mr. HARTSON. That is the thing I have reference to, Senator—the fact that it was charged that this Government agent had mentioned to the taxpayer the name of an attorney, who, if employed, might represent him to his benefit and to his advantage in the bureau. That charge, that specific one, was the thing that I had reference to. That was the subject of investigation by the commissioner, and I think he has a record of it, and will be very glad to submit it to the committee.

Senator KING. Is Mr. Kennedy still in the employ of the department.

Mr. HARTSON. No; I think not. But he was not discharged as a result of this investigation and this charge.

Senator KING. Is he practicing before the department now?

Mr. HARTSON. I am not informed as to that. I do not know.

Senator KING. Please have some member look that up and advise advise us.

Mr. HARTSON. I am informed by Mr. Bright that he is employed in the Government service now, but he is not in the employ of the Bureau of the Internal Revenue; but I would like to make it plain that he was not discharged from the bureau as a result of this charge. The commissioner, I think, reached the conclusion that the charge was unfounded, as the result of this investigation.

Senator COUZENS. From what appears to be a reliable source of information comes to me this statement:

Mr. George O. May, senior partner of Price, Waterhouse & Co., states, confidentially, that he is satisfied from his own experience and the experience of his friends and clients that the income-tax department in Washington is virtually honeycombed with corruption, and that "colossal" sums have been collected from individuals and corporations for securing refunds of income-tax assessments.

Do you deny ever making such a statement as that?

Mr. MAY. I repudiate that statement altogether; yes.

Senator COUZENS. You repudiate it altogether?

Mr. MAY. Yes.

Senator COUZENS. The memorandum further says:

He says he knows of an instance where "a very prominent corporation" was taxed an additional $3,000,000 on account of property amortization. It was then approached by a fixer, who said he would secure a refund if he was paid a percentage of the refund. The agreement was made and the tax was refunded, although the fixer or any of his agents had never visited the plant of the corporation in question.

Do you know of any such case as that?

Mr. MAY. No; I never made a statement of that kind.

Senator COUZENS. Well, do you know of a case like that?

Mr. MAY. No.

Senator COUZENS. You never heard of a case like that?

Mr. MAY. I never heard of a case like that. I have heard indirectly of suggestions of fixing of amortization claims, but I never heard of a case that is any approach at all to an accurate description of it.

Senator COUZENS. Do you know of any specific case involving a large amount that was handled in some such manner as that?

Mr. MAY. No.

Senator KING. Well, do you know of cases of amortization of large amounts, which resulted in a reduction of taxes?

Mr. MAY. Of course, amortization claims in large amounts have undoubtedly been made, that have resulted in tax reductions. The amortization section is an extremely difficult section to administer. The regulations have been changed on it so much that returns made in accordance with the earlier regulations, when the thing was undeveloped, have naturally been amended, sometimes very much in favor of the taxpayer, as the result of the reconsideration of the amortization.

Senator KING. That would affect a large number of corporations?

Mr. MAY. Yes; undoubtedly.

Senator KING. And the benefits to them, in the aggregate, would be very large, in your opinion?

Mr. MAY. Oh, yes; they must be.

Senator KING. Is that work of amortization going on now, as the result of which these deductions and credits are being received?

Mr. MAY. The amortization is still unsettled in a large number of cases.

Senator KING. From your examination or from your own experience, do you find that their method of construing the statute has been variable and contradictory?

Mr. MAY. Well, it has undoubtedly changed. It is an extremely difficult problem. I have been consulted at different times as to the bases for regulations, and I regard it as one of the most extremely difficult sections of the act to administer. I think, undoubtedly, the first regulations were drawn rather drastically, with a view to discouraging undue and excessive claims for amortization, and the board has found that it has had to liberalize its position beyond the position taken in those first regulations. It was a subject that required a very great deal of study, and, naturally, until that study could be had, they had to make some tentative regulations to cover the situation in the meantime. It was only natural that they should have erred on the side of conservatism from the Government standpoint, leaving the liberalization to come later when the subject was more developed. I think that is an entirely natural and legitimate course on the part of the bureau.

Senator COUZENS. Have you had any conferences with Mr. Mellon recently?

Mr. MAY. I saw Mr. Mellon this morning; yes.

Senator COUZENS. I mean outside of this morning. When was it the last time you saw him prior to this morning?

Mr. MAY. I do not think I have seen him since Congress met. I think the last time I saw him before this morning was in November.

Senator COUZENS. At that time, did you tell him about the conditions in the bureau?

Mr. MAY. I have frequently discussed conditions in the bureau with him.

Senator COUZENS. Did you tell him at that time that they were bad?

Mr. MAY. I told him where I thought there were weak spots. There are bound to be, of course.

Senator COUZENS. Were there any changes made after you had this interview some time ago with Mr. Mellon? Did any change follow in the bureau after that?

Mr. MAY. I am not sufficiently intimate with the affairs of the bureau to know.

Senator COUZENS. You made certain suggestions, as I understand it, to the Secretary as to what you thought he ought to do to eradicate the evil which you had been complaining about?

Mr. MAY. Well, I have talked to the Secretary about these things, because I have felt a very keen interest in them, and made various suggestions at different times.

Senator COUZENS. What did you tell him you thought ought to be done to eradicate this evil, when you were talking to him last, before to-day?

Mr. MAY. To eradicate which particular evil?

Senator COUZENS. The evils that we have been talking about—fixers and assessments being advised of in advance—and things of that sort.

Mr. MAY. I do not think I was talking about this class of question so much with him then, because these cases that I have alluded to are not recent cases, and that has not been the serious factor. I think the thing I have talked with him more about was the question of getting some of these old cases cleared up.

Senator COUZENS. Did you tell him how you thought he ought to proceed to clean them up?

Mr. MAY. No; I did not. I do not think I presumed to do that. I think I merely told him that I thought there might be a wrong impression derived from a purely statistical view of the situation, in which each case was treated as a case. I have felt for a long time, and I have impressed it on the Secretary, that it was my judgment, whenever I have seen him, that the work of the bureau fell into two parts; one what you might call a mass production job, going through and examining a large number of relatively small returns, and the other was a unit production job; that is, each case a study in itself; a relatively small number of very important cases. The statistical record by which the degree of progress was measured by the number of returns disposed of gave, I thought, a sense of false security, unless it was further analyzed to see whether it was the relatively unimportant or the relatively difficult cases that were being held up. Of course, it is a natural disposition to put the hard nuts to one side and go around and crack them when you have a little more leisure. So I felt that there should be some way devised to make a drive to clean up the comparatively small, in regard to total returns, the comparatively small number of returns of much importance, which were of importance to the business community and to the Government.

Senator COUZENS. What did you suggest should be done to do that?

Mr. MAY. Well, I did not make suggestions in detail, because you could not do that without going into the bureau; but my idea was that they should be treated as separate problems from routine problems of putting the millions of returns through the mill and dealing with them as a separate problem.

Senator COUZENS. Do you know a man by the name of Bell, who was head of the assessment section?

Mr. MAY. I do not think I ever met him in my life. I have heard of him.

Senator COUZENS. Do you know a man by the name of Bird, who succeeded him?

Mr. MAY. Yes; Bird was in my office at one time.

Senator COUZENS. Is he employed there now?

Mr. MAY. No.

Senator COUZENS. He is not employed in the bureau?

Mr. MAY. No.

Senator COUZENS. Do you know where he is?

Mr. MAY. I believe he is in Florida.

Senator COUZENS. Retired?

Mr. MAY. No; he is connected with some bank or trust company in Florida. He was the last I heard of him.

Senator COUZENS. Have you, in your dealings with the bureau and your clients, had cases settled on the basis that it was a clerical error?

Mr. MAY. On the basis that what was a clerical error?

Senator COUZENS. That the assessment or the proposed assessment was a clerical error. Were you informed of some of these cases where assessments were made or proposed and when it was shown to the department that there was a clerical error they admitted it frankly?

Mr. MAY. Well, I do not know. I do not know of any case where the assessment was disposed of as being entirely a clerical error except in the sense that the assessment was in error, because the tax had already been assessed, which was a duplicate assessment. That would be a clerical error. Of course, however, there have been very large clerical errors made in assessing returns. I remember one case where the adjustment resulted in allowing as capital paid in a minus quantity, because they deducted for intangibles, and then they deducted an amount at the bottom for capital stock which was larger than the amount that had been left in above. That obviously left a minus quantity for capital stock paid in. Of course, that was adjusted without very much difficulty.

Senator COUZENS. Have you ever given an interview, confidential or otherwise, to a newspaper man relative to conditions in the bureau?

Mr. MAY. I never gave an interview to a newspaper man. A newspaper man called on me one day and asked me for information and to make any suggestions in regard to this question, which he was going to investigate. I told him that there was a lot of gossip about it, and I thought there was no harm in investigating it. I mentioned one or two cases that came to my notice. He asked me some questions, and I said, "Yes; undoubtedly very large fees had been paid by corporations to people for handling their taxes," and he asked me a number of questions, and I gave him certain answers.

Senator COUZENS. Did you tell him that you knew of Mr. Guil Barber down here, a tax expert?

Mr. MAY. I do not know. I may possibly have mentioned his name.

Senator COUZENS. Do you know Mr. Barber?

Mr. MAY. No.

Senator COUZENS. Do you know of him?

Mr. MAY. I have heard his name mentioned.

Senator COUZENS. Do you know of his getting any large fees from any of your clients or friends?

Mr. MAY. No, sir; he has never gotten any from any of my clients, but he approached some of my clients, and told them, I guess, that he got large sums for other people; but, so far as I know, none of my clients employed him; at least, I do not know of any; certainly none that we have ever handled any tax matters for.

Senator COUZENS. Did he get any big fees out of any of your friends that you know of?

Mr. MAY. No.

Senator COUZENS. Did you ever mention Mr. Barber's name to Mr. Mellon?

Mr. MAY. Yes.

Senator COUZENS. In what connection?

Mr. MAY. I just mentioned it as having heard that story about him.

The CHAIRMAN. What did Secretary Mellon say when you told him that?

Mr. MAY. He just took a note of his name.

The CHAIRMAN. Had he been in the service before?

Mr. MAY. I did not know anything about him, excepting that.

Senator KING. Yes. We had him here as a witness the other day.

The CHAIRMAN. Yes; I know.

Mr. MAY. Some of my clients came to me and told me that he had approached them, and claimed to have done these things, and they asked me whether I thought there was anything to be gained by their employing him. I said no. They said all right. That is all.

Senator COUZENS. Do you know the firm of Humphreys & Day?

Mr. MAY. Yes; I have heard of them.

Senator COUZENS. What was their business?

Mr. MAY. They had a tax business. I think they were primarily engineers.

Senator COUZENS. Did you ever come in contact with them?

Mr. MAY. I never came in contact with them personally; no.

Senator COUZENS. Is the International Mercantile Marine Co. one of your clients?

Mr. MAY. Yes.

Senator COUZENS. Have they been approached?

Mr. MAY. Oh, Phil Franklin told me he had been approached innumerable times.

Senator COUZENS. In what way?

Mr. MAY. By people coming to him who were recommended by this person or that. They said they could do a special service for them in tax matters. He just mentioned it to me, and said, "As long as you and our counsel are handling the case, I just mentioned it to you. If you think there is anything to be gained by going into it further with him, say so."

Senator COUZENS. Did he tell you what fees were asked by these solicitors?

Mr. MAY. I do not recall now. He never entered into any sort of negotiation with any of them, so far as I know.

Senator COUZENS. Do you know of a case where a firm that intended to float a security issue paid $68,000 for a tax refund to a former employee of yours?

Mr. MAY. They paid him, not for a refund, but they paid him. I remember a case where there was a former employee of mine who got $60,000 fee from a corporation. I do not know what results he got for them.

The CHAIRMAN. Pretty good results that he got from them.

Mr. MAY. Personally; yes.

Senator KING. Was it a tax case?

Mr. MAY. Yes.

The CHAIRMAN. Tell us about that.

Mr. MAY. Well, we just happened to be in examining the accounts of the company——

The CHAIRMAN. What case was that?

Mr. MAY. Do you wish me to mention the name?

Senator COUZENS. He was not a client of yours.

Mr. MAY. This concern was; yes. They became clients of ours when we examined their accounts, at the instance of the banking firm.

Senator COUZENS. Yes; but they had already——

Mr. MAY. They paid the bill.

Senator COUZENS. They had already been investigated.

Mr. MAY. They had already paid him.

Senator COUZENS. So that when they paid him, they were not clients of yours.

Mr. MAY. No.

Senator COUZENS. Why can you not tell us, when they were not clients of yours, when that transaction took place?

Mr. MAY. My knowledge came to me through their being clients of mine.

The CHAIRMAN. Did it pay you to take them on as clients after they had paid the other fellow $60,000?

Mr. MAY. We did not do any tax work for them.

Senator COUZENS. Was it $60,000 or $68,000?

Mr. MAY. It was somewhere around $60,000.

Senator COUZENS. And I understand that he was about a $4,000 a year man; is that right?

The CHAIRMAN. What is his name?

Mr. MAY. Townsend.

The CHAIRMAN. Townsend?

Mr. MAY. Townsend; yes.

The CHAIRMAN. Had he been in the bureau?

Mr. MAY. He was in the bureau for a time.

The CHAIRMAN. How long after he got out did he take this case?

Mr. MAY. I do not remember.

The CHAIRMAN. What was the amount involved?

Mr. MAY. I do not know anything about it, except that in analyzing the expenses of the firm we found that they had paid him roughly $60,000.

The CHAIRMAN. Do you know anything about the amount involved or what the proposition was?

Mr. MAY. I do not know anything about it, sir.

The CHAIRMAN. Or what service was rendered?

Mr. MAY. My partner brought the matter to my attention, and he said he thought it was largely money thrown away.

Senator COUZENS. Where is Mr. Townsend now?

Mr. MAY. I have not the slightest idea.

Senator COUZENS. Do you know, Mr. Smith? You are connected with Price, Waterhouse & Co., are you not?

Mr. W. M. SMITH. The last I heard of Townsend he was in New York.

Senator COUZENS. The last you heard of him he was in New York? Do you know his initials?

Mr. W. M. SMITH. It seems to me that they are J. L., but I am not positive.

Senator KING. Was he doing tax work when you last heard of him?

Mr. W. M. SMITH. I saw Townsend here in Washington about 45 days ago.

Senator KING. Was he doing tax work?

Mr. W. M. SMITH. I believe so. He was around the income-tax bureau.

Senator KING. He was not an employee of the Government then, 45 days ago?

Mr. W. M. SMITH. No.

Senator COUZENS. What is your opinion, Mr. May, of the efficiency of the bureau?

Mr. MAY. That is a pretty hard question. It is one of those things that you can not generalize on. I do not think I have a sufficiently broad knowledge to generalize on it. I do not think it is quite fair to talk about their efficiency, except in relation to the magnitude of the task that they have.

Senator COUZENS. Well, I know; but you are familiar with the organization there?

Mr. MAY. As a matter of fact, I do not get into it at all. The only people there that I come in contact with are the committee on appeals, and occasionally a section head. The only cases that I come down here personally on are important appeals and things of that kind.

Senator COUZENS. Well, you must know something about that.

Mr. MAY. But I have some ideas on the general subject of the efficiency of the bureau; and, if you want me to say it, I think, before you can approach the question of the efficiency of the bureau, you have to consider the task that was laid on them.

As is well known, the tax law of 1917 was passed in a rather hurried way, and was the result of a compromise between two bills, drawn in the Senate and House, respectively, on very different lines; so it was not a homogeneous or consistent whole. As an administrative problem, it was almost incapable of being administered as it then stood.

The then commissioner called in a group of advisers to assist him in framing regulations; and, as I understand it, the chairman of the Senate Finance Committee and the chairman of the House com-

mittee conferred with them, and regulations were drawn up which interpreted the law somewhat broadly. It was a law that, to do justice, had to be administered pretty broadly; and yet, at the same time, there was always the basic rule of law that the construction of a tax statute must be a narrow construction. So that the Treasury was in the position that the law, to be administered effectively, had to be interpreted broadly, where, if they were thrown into the courts, they would be thrown back on the letter of the law. So that constituted an extremely heavy burden on the bureau.

Then, in the second place, the idea of invested capital, the March 1, 1913, situation, with the idea that everything at March 1, 1913, was capital, and the determination of losses or gains, depreciation and depletion, and in the 1918 law, the provision for amortization, threw on to the bureau a problem in valuation, the magnitude of which, I think, has been consistently underrated, both by Congress in imposing it on the bureau, and by the bureau in undertaking to fulfill it.

I say that task was a very much bigger task to be done efficiently than the task imposed on the Interstate Commerce Commission in valuing the railroads. The Interstate Commerce Commission has been at that work for 10 years, and they have spent $25,000,000 themselves, and the carriers have spent $75,000,000, in carrying out the instructions of the commission. This one problem in valuation that has been presented to the bureau, in the aggregate, was a bigger problem in valuation than that which was presented to the Interstate Commerce Commission; and I think, if I may say so with all respect, Congress imposed too heavy a burden on the bureau, without providing adequately for its discharge, and I also think that the bureau, perhaps, is open to criticism for never sufficiently bringing out the magnitude of its task and the inadequacy of its facilities for carrying it out.

The reports of the commissioner I would say, have been inspired by optimism, and have distinctly underrated the magnitude of the task. The consequence is that the task has dragged.

I can not help feeling personally that the putting of the prohibition unit under the same jurisdiction as the tax bureau was bound to have a very detrimental effect on the work for a time afterwards.

I think those are the three factors: First, the law being particularly and extremely difficult to administer; the valuation problem, and the prohibition factor, together with the fact that the income tax was new in 1913, and we plunged into the period of very high taxes in 1917. They constitute a basic situation which you must take into account always in recalling the efficiency with which this task has been performed.

Now, considering that and considering the limitations on prestige and pay of the men that are called upon to discharge those functions, I think there has been some very admirable work done in the bureau, although there has been some very disappointing and discouraging work from the standpoint of anyone being with the bureau; but I do not in the least feel that it is a case for unmeasured condemnation. The opportunities for men to make money on the outside have created a turnover in the service which is bound to be very embarrassing to the bureau, and the difficulty of problems like amortization, with the constant necessity for modification of rulings as the situation

developed more clearly, has created an apparent inconsistency and delays in reopening of cases which are very exasperating; yet the more you know of the conditions, the more excuse you are prepared to make for the people who have been struggling with the task.

That is, broadly, my feeling on the subject.

Senator COUZENS. Do you want to ask the witness any questions, Doctor Adams?

Doctor ADAMS. Yes; I would like to ask him a few questions at this point.

Mr. May, referring to the question of getting a broad and accurate cross section, as you speak of it, what would be the best way to find out, first of all, the number of business concerns that have been approached? What would be a possible way of doing that?

Mr. MAY. I think, as far as that goes, you may assume that practically every business has been approached by someone; but if you want to get down to approaches by ex-employees of the bureau, or get anything about the nature of the arrangements, or anything of that sort, the only thing I could suggest would be to take some representative list of big corporations, say, on the New York Stock Exchange, or something of that sort, and pick out a substantial number of large corporations, and ask for specific information from them. With, of course, your power of subpœna in reserve, if you do not get what you want by correspondence, you can take their statement under oath. From that, you would get testimony such as you might see fit to use; but unless you do something in that way, you are apt to get a partial picture, unless you do something that cuts right across and gives you a fair cross section.

Doctor ADAMS. I want to ask a similar question about delays in the assessments. The statistics of the settlement of cases seem to indicate that only a small fraction of 1 per cent of the 1917 cases remain to be settled, and there is a very small percentage of the 1918 cases that still remain to be settled. I have no doubt that those statistics are absolutely accurate. Do you think that they represent the real situation?

Mr. MAY. Well, as I say, they do not fully represent the situation, unless you know something about the importance of the cases that are unsettled.

Doctor ADAMS. Have you made any test, for instance, of your own companies to ascertain how many of them still have cases for 1917 or 1918, or both, unsettled?

Mr. MAY. Yesterday, before I came down, I asked our people to get a list, to just pick out some of the companies listed in the active stocks on the New York Stock Exchange in 1917—not those that are now listed, but those that were listed in 1917 and actively dealt in. I told them to get whatever they could find in the way of information readily to hand, and they were able to give the information on 20 of those cases; and more than half of those still had 1917 taxes unsettled. Now, we may have been more unfortunate; our clients may be more unfortunate. I could not say whether that was representative or not; but it seems to me that you could do something of that sort. Ask the bureau to take the companies listed on the New York Stock Exchange, all of the companies above a certain size, and classified according to whether the 1917 and 1918 taxes had been disposed of. That would give you some idea of the situation.

You might ask them to show what questions mainly are left undisposed of. For instance, amortization, as I say, was the main factor in the law in the 1918 cases, and you could see how fair it was presumably to specific situations.

I think, then, from that starting point, you could investigate the causes of delay in those representative large companies, advantageously, and I think you will find they are due to a variety of causes, the bureau not being responsible for all of them. The activities of tax advisers are partly responsible for it; and when you get corporations which have exhausted all of their regular channels and have had a settlement that was satisfactory to the bureau, some one comes along and says "We will take this up again afresh for you, and we will receive pay only if we get something more back for you"; so they reopen cases which the bureau is perfectly willing to allow remain closed.

On the other hand, there are some of them that present very difficult questions which I think it is going to be very difficult to get men in the bureau to assume the responsibility of deciding. Some of them involve very large amounts of taxes, and there is naturally an indisposition to face the responsibility of deciding those, and I rather fear that this investigation will increase that indisposition. They will be afraid to decide in favor of the taxpayer, perhaps, or, perhaps, they will think that they are not justified in deciding in favor of the Government. So they will let the thing drift.

Then you will find there are companies—and I want to be perfectly fair in the matter, I think possibly some of my own clients are in that category, that know they are going to pay the tax in the long run, and as long as interest is not running against them, they would just as soon let it drift. Some of them would rather clean it up, and have the thing out of the way, interest or no interest. Others take the view, "Well, as long as we are not paying interest, why should we press the case?"

The main feeling, I think, about the whole situation is that unanalyzed facts are as apt to be misleading as no facts at all on most of these situations.

Senator COUZENS. While the percentage of the unsettled claims is small in the aggregate, it represents a great many thousands of cases, does it not?

Mr. MAY. I should think it must.

Senator COUZENS. Yes. In most of those cases, have you any idea who holds the bag—the taxpayer or the Government?

Mr. MAY. There are lots of cases where the Government would say there was money coming to it, and the taxpayer would say there was money coming to him.

Senator COUZENS. In those cases that you analyzed before you came down here——

Mr. MAY. Well, I did not attempt to analyze them. I just tried to make a separate list of the cases, according to whether they were settled or unsettled.

Senator COUZENS. Were you intimately acquainted with those cases?

Mr. MAY. My office was. I am personally acquainted with some.

Senator COUZENS. Do you know whether most of those cases are cases in which the Government is holding the bag or cases in which the taxpayer is holding the bag?

Mr. MAY. I think the general situation is that the Government thinks there is an additional tax due, and the taxpayer thinks there is a refund.

Senator COUZENS. In other words, then, in most of the cases where the Government makes an assessment, it does not collect, because of the——

Mr. MAY. These are not mostly cases where assessments have been made.

Senator COUZENS. Tentative assessments.

Mr. MAY. Yes; proposed assessments in the bulk of them.

Doctor ADAMS. Do you think, Mr. May, that those cases would be facilitated by the appointment, if it could be done, in the proper way, of what some people call a "mop-up" commission composed of men who would have the confidence of the corporations, who could pass on some of these questions which require a great deal of discretion, and where the exercise of the highest judgment is required? In other words, is a "mop-up" commission a promising remedy of that situation?

Mr. MAY. Personally, I have always felt that they would never get cleaned up satisfactorily until something of that kind was done. I have had that idea for some years. I thought during the war that the main job was to win the war, and to win it as quickly as possible, in order to get it done and over with, even though it might cost a little more. I think that was the right policy, to clean it up. In the long run, I think the more these settlements are delayed the more it is going to cost the bureau and the taxpayer.

Senator COUZENS. Do you believe in a "mop-up" commission?

Mr. MAY. A mop-up commission with sufficient prestige. I do not think the question of pay would be so important there, but it would be a question of prestige upon the part of the men who are willing to do once more a patritoic service growing out of the war, and whose decisions on questions of fact would be accepted, and should be made, by law, binding on the courts on the questions of fact that they have dealt with, and whose findings would be accepted by the business community generally and by Congress and others as at least fair and impartial. You would have to give them pretty wide powers, without any attempt at splitting of hairs.

Senator COUZENS. The commissioner made the statement that by the end of the fiscal year 1925, all of these cases would be current. Do you agree with that?

Mr. MAY. But the end of 1925?

Senator COUZENS. By July 1, 1925.

Mr. MAY. It would be cheerful news to a great many of my clients if they thought the 1917 cases were to be disposed of by them. I am not referring to the number. The number is small, though the amount in dollars and cents is large.

Senator COUZENS. The number in the aggregate presents quite a problem in itself; but you do not agree with the optimism on the part of the commissioner that by the end of the fiscal year 1925 all of these cases will be current?

Mr. MAY. I do not think they can be.

Doctor ADAMS. Mr. May, a part of the delays comes from taxpayers in repoening cases after a settlement has been made, through tax fixers, etc. Do you think it would be desirable for the Govern-

ment to propose, of its own initiative, the use of section 1312 every time it makes a settlement; that is, make a settlement final and conclusive?

Mr. MAY. I think the time has come where that would certainly be a good policy as regards 1917, and perhaps as regards 1918, if not the later years.

Doctor ADAMS. May I ask Mr. Hartson or any of the other representatives of the bureau here whether the Government has ever, of its own initiative, proposed a settlement under 1312?

Mr. BRIGHT. It has not.

Doctor ADAMS. So that at any time, on the cases settled in the ordinary way, the taxpayer can reopen it, if it has been paid under the provisions of 1312?

Mr. BRIGHT. He can, within the statutory period.

Doctor ADAMS. Have you any instances of the question I asked, where it might seem desirable for the Government to propose settlement under 1312?

Mr. BRIGHT. It could be done for all years where invested capital is involved.

Senator COUZENS. Mr. May, have you any idea as to how the work of the bureau might be simplified?

Mr. MAY. Well, that is a pretty large question.

The income-tax problem in this country is extremely difficult, as I see it. I have been a student of the subject for some years, and I am fairly familiar with the British practice. I compare the two, and on comparing the two, I am impressed with the magnitude of the difficulties that exist here, and which do not exist there.

Senator KING. In Great Britain?

Mr. MAY. Yes. So that I think the comparison between the two must be conditioned by a recognition of those absolute advantages that they have.

Doctor ADAMS. May I ask you a question right here?

Mr. MAY. Yes, sir.

Doctor ADAMS. I think you will agree that a large part of our difficulty comes from valuation, and that a large number of those valuations are concerned with capital assets, so called. Now, at the present time, we have a limited rate on gain derived from the sale of capital assets, and it is proposed in the House bill to limit the allowance for losses. In that connection, my question is this: Assuming that the action reported in the newspapers by the Senate committee, namely, of limiting the rate to 12½ per cent of the gains, but allowing losses in value; assuming that that goes through, do you believe that the Government would gain or lose by eliminating the taxation on capital gains and losses altogether?

Mr. MAY. If they would cut out the limit on losses, they are bound to lose.

Senator KING. Surely.

Doctor ADAMS. Therefore, do you think that if they maintain that attitude toward losses, we could simplify the law indefinitely by abolishing all reference to capital gains and losses?

Mr. MAY. Of course, as I think you know, that is a subject that I have been very much interested in. I wrote a paper on that subject, which you have read, undoubtedly. My mind has been working

toward the solution of it, in spite of the prima facie arguments in favor of taxing capital gains; but from the standpoint of revenue, it would be better to eliminate taxation of capital gains and allowance of capital losses.

Senator KING. It may be interesting to know that I have an amendment, as one member of the committee, to strike out all of those provisions of capital losses and gains. I reached that conclusion long ago.

Mr. MAY. Of course, in all of these changes, you usually exchange one set of troubles for another.

Senator KING. Yes.

Mr. MAY. But you find the weak points in method largely by experience, and you do not want to reject a method, when you have found out its weak spots by experience, without very carefully canvassing the weak spots of any alternative that you are going to adopt. It is not difficult to sort of cast what is really income into the form of a capital gain.

Senator KING. There is the danger.

Mr. MAY. Personally, I do not think that the drafting of provisions that would put a reasonable limit, that would stop a great deal of that kind of evasion, would be anything like as difficult as the drafting of the restrictions under the present law.

The CHAIRMAN. But, after all, that is a question of policy for the taxing committee, rather than improving the methods of the Internal Revenue Bureau.

Mr. MAY. Well, it is on the question of simplification. It will undoubtedly be a great simplification.

The CHAIRMAN. I know; but you can not afford to change the whole taxing policy in order to simplify the method of calculation.

Mr. MAY. But I think, if well drafted, it would not involve any sacrifice of revenue. That is my general impression.

The CHAIRMAN. Well, we have that general impression on the Finance Committee, and it is now formally in the tax bill, but, after all, that is quite apart from the question of simplifying the method of tax assessment.

Senator KING. Speaking for myself, I would like to get his views on that substantive proposition, because we are passing a tax bill, and the views of some of us may prevail even against the intransigeant views of others, you know.

Doctor ADAMS. Coming back to the question I asked you, if, under the law, a period of four years is allowed to complete the assessment, should not the field examination be made at least 18 months in advance of that limit? In other words, if we want to facilitate settlement, should there not be some directions with respect to the time that the field examination is made?

Mr. MAY. Certainly, as a matter of policy, if I were the commissioner, I should want to lay down some thing of that sort as a general rule. In order to complete it within four years, we must have the field work done within two years and an half; but I should not think, if you ever got current, or got back to a position where, at any rate, the corporation tax rate was not fluctuating violently from year to year, the work ought to be done in not anything more than a fraction of what it was in the war years. The great difficulty to me arises from the fact that in a big business the allocation of income to

one particular year is more or less theoretical. The business is not in business for one year. Every year's operations inherit from the past, and leave legacies to the future, and to pull out one year and ear-mark it for the amount of income that can be attributed to that year, is, at best, as one of the English judges said, a matter of estimate and opinion.

Now, when so much depends on which side of December 31 you will throw a given amount of income, as was the case with fluctuating profits, with fluctuating tax rates during the war period, the difficulties of the whole problem are enormously enhanced. If you get down to a relatively low tax rate and a uniform tax rate, particularly on corporations, your task is immensely simplified, because nobody is going to waste time on whether he should pay the tax this year or next year, if he has to pay exactly the same tax, whatever year it is. So I think the whole time limit, once you get the work current, should be cut down altogether.

Doctor ADAMS. You think that four years, then, intrinsically is too long?

Mr. MAY. Under those conditions.

Doctor ADAMS. May I ask you, in general, about valuations? I ask that because I think that no one thing so conduces to delay and complexities of tax laws as the necessity for valuations. I would like to know, first, if you indorse that general view?

Mr. MAY. Oh, yes; that is, a large part of it.

Doctor ADAMS. It would follow from that, then, that valuations should be omitted and eliminated wherever possible?

Mr. MAY. Yes; the more you can do without valuations, the better.

Doctor ADAMS. I would like to ask you if you have any general notion about the reasonableness, the excess or defect of valuations, made for the purposes of depletion?

Mr. MAY. Well, speaking for myself personally, I have always felt that valuations for tax purposes, for mineral areas, were too high. I mean not only for income tax purposes, but for local tax purposes.

Senator KING. Pardon me, but you know, of course, that in a great many States they do not tax the property, except the improvements. It is a tax upon the mineral output.

Mr. MAY. Yes; but in Minnesota, etc.

Senator KING. Oh, yes.

Mr. MAY. I think the Minnesota valuation of mines has cost the Federal Government a lot of money, because they value the mines, as I recall, on a 4-per cent basis.

Doctor ADAMS. The Michigan valuation.

Mr. MAY. Michigan was 5 per cent, as I recall, and Minnesota at one time was on a 4 per cent assessment basis. They got a very high valuation fo the mines. When you were valuing those same mines for income-tax purposes, and those valuations were made long before March 1, 1913, in Minnesota, and you were predicating the calculations on the assumption that local taxes on those high valuations would continue, it was very difficult to resist the argument of the taxpayer that he is entitled to at least as high a valuation for depletion as he is for the purpose of tax on capital. That, to my mind, started off depletion valuations on a high level.

Then, again, there is another factor that is almost impossible to get out of your mind. It is almost impossible for a man, after a period

of inflation has gone, when prices were high, to get his mind back in the state in which it would have been on the 1st of March, 1913, and make a retrospective valuation, which absolutely ignores everything that has happened since. It is almost impossible to do it, and I think the tendency, therefore, from that cause also has been rather upward, on the high side. That is my general theory.

Doctor ADAMS. Mr. May, it is common knowledge, and I think public knowledge, that the Treasury Department has ordered a revaluation of copper and silver mines for the years 1919 and thereafter, in the belief that the depletion valuations used for 1917 and 1918 were partly erroneous, or too high. My question is, Will that raise unusual and peculiar difficulties in the future in making that change?

Mr. MAY. I do not know. I have not given very much thought to that.

Doctor ADAMS. I was wondering if you had any solution of what seems to me a very difficult problem.

The CHAIRMAN. What is your solution, Doctor Adams?

Doctor ADAMS. I was asking Mr. May, for the time being.

The CHAIRMAN. I know, but I am asking you. He says he does not know.

Doctor ADAMS. I am going on the stand on the question of depletion some time, and I would rather reserve my remedy until then.

The CHAIRMAN. I would like to hear your remedy, myself.

Doctor ADAMS. Finally, I want to ask you this about depletion, Mr. May——

The CHAIRMAN. Chairman Green of the Ways and Means Committee, would also like to hear you on that question.

Doctor ADAMS. I shall be hearable some time. I want to ask you this question:

In general, if any method fair to the industry can be devised to replace the present discovery depletion, which in the case of oil and gas calls for recurrent and continual valuation, would it not be most desirable to substitute a different method?

Mr. MAY. I should say decidedly so.

Doctor ADAMS. In other words, the valuation in itself is to be avoided if any satisfactory substitute can be secured?

Mr. MAY. Personally, I have always felt that it was unfortunate that that discovery provision got into the law.

Doctor ADAMS. If the chairman will permit, no remedy is secured by reducing the valuation 50 per cent of the operating profit. That is not a real remedy, if something better can be secured. It leaves the problem of recurrent valuation there.

The CHAIRMAN. It does all the time, but you can not get away from valuation, can you, Doctor?

Doctor ADAMS. I think it may be possible, and I hope that the department, some representatives of which are present——

The CHAIRMAN. Yes?

Doctor ADAMS (continuing). Will bestir themselves to make suggestions to get away from a method by which it would be infinitely difficult to get rid of, problems of valuation, the solution of which problems means the exercise of judgment and differences of opinion, mistakes and delay. If there is any human way of getting away from that, the Government of the United States ought to get away from it.

Mr. MAY. I should think the appointment of committee, under the chairmanship of Doctor Adams, composed of representatives of the bureau, engineers, accountants, and so forth, might be able to make a useful report on that. They would be glad to serve voluntarily, without pay, if they were asked to.

The CHAIRMAN. I think that is a very fine suggestion on your part, that they serve gratuitously.

Mr. MAY. I am sure that they would be willing to do that.

Senator KING. We will add Mr. May to that committee.

Mr. MAY. Well, I would be willing to serve gratuitously on such a committee.

The CHAIRMAN. Let me ask, while on that point, whether any of these gentlemen representing the bureau have given thought to this matter.

Mr. HARTSON. I made the suggestion yesterday, Mr. Chairman, that any proposed change which would relieve the bureau and its officials from reaching these determinations on questions involving judgment and discretion, about which there can be a reasonable difference of opinion, would be welcomed by the bureau officials and by the bureau. So far as eliminating entirely the necessity for making these determinations with regard to value, I think that would be most difficult to do under the law as it is.

The CHAIRMAN. There is no way in which you can avoid any valuation.

Mr. HARTSON. I do not see how it can be done; but on this question of depletion, about which there has been so much said, I see no way of eliminating the necessity for making a valuation, unless you eliminate depletion entirely from the law, and that becomes a question for Congress, of course. Congress is now contemplating the limiting of the depletion allowance to 50 per cent of the net income. If they can do it to that extent, they could eliminate it entirely, I assume.

Doctor ADAMS. That is discovery depletion.

Mr. HARTSON. Yes; that is what I am speaking of. I should have qualified that to that extent. But I do not see, Doctor Adams, how it can be eliminated under any reasonable law that can be framed; that is, to eliminate the necessity of making these valuations and determining them.

The CHAIRMAN. Is not the delay in the settlement of these cases in the department owing to that one thing?

Mr. HARTSON. I can not estimate it, but it is very large, simply because the Government has its engineers, who go out and make valuations which are in accordance with that individual's view as to value. He comes in, and the taxpayer appears with his counsel and with his engineers, and his engineers, in turn, have made a valuation, and they are at opposite ends of the pole. It is the same way as you come into a court of law to determine the valuation of a piece of real estate. You will have the plaintiff and the defendant appearing by qualified experts, who will testify, and their figures and estimates will be at variance, and at very great variance.

Somebody in the bureau, clothed with this authority to be a judge, on the one hand, and at the same time protect the Government's interests and not violate the interests of the taxpayer, has to determine between the field agent's report and the Government's engineers

and the engineer of the taxpayer. I know of no way of eliminating it entirely. The surest way to reduce it is to prohibit by law some of the allowances that have been made of this character.

Doctor ADAMS. Mr. Chairman, you have asked me for the remedy. I would rather defer that, but I think, in general, certain carefully selected percentages of gross income, or operating income, would have been infinitely better for the taxpayer, for the United States, and for everybody else had they been adopted by the Government from the beginning, and it may be distinctly practicable to adopt them from now on if Congress wants to do it. These hazardous industries have an allowance for risks and hazards. It should be a general allowance, but it should be a simple allowance, and there are simpler methods of making allowances than those authorized by statute.

I want to ask Mr. May one other question.

Mr. May, I think the committee would be interested in having your view, even though it be general, about the number of important business concerns, which, under normal circumstances, would be run as partnerships and which are now run as corporations, for the purpose of avoiding surtaxes.

The CHAIRMAN. That is a good question.

Doctor ADAMS. To what extent have accountants, investment bankers, and similar concerns, which would naturally prefer the partnership form, either changed over into corporations or employ subsidiary collateral corporations to accomplish this end?

Doctor ADAMS. In the first place, you might start with your own concern; is it a partnership or a corporation?

Mr. MAY. We cling to the partnership for the sake of prestige. It is a rather expensive luxury, but we still do it. I do not know much about accountants; I suppose a man generally does not know much about his own colleagues, but undoubtedly investment bankers and large numbers of businesses generally that can be incorporated have been incorporated; and, of course, they may retain the firm, do a certain business, but they have a firm and a corporation. Undoubtedly this has extended very widely, and I am quite concerned.

Senator KING. How can that be avoided; what change in the tax law would avoid driving into corporate form many of the individual and partnership activities and enterprises now in existence?

Mr. MAY. Well, I very much doubt whether any changes in the law would be very effective in that direction in the administrative features of the law. I do not know if you have stopped to think about it, but that is one of the great handicaps that we are under in this country—the State law governing and controlling corporations and the Federal law collecting the tax. In Great Britain the same parliament that levies the tax has control of the corporations.

In England they prescribe that a certain tax shall be paid by private companies not subject to the regulations applicable to the public companies which makes the returns on the same footing as partnerships unless they are prepared to fulfill all the requirements of a public company. They are in no better position than partnerships. That kind of a regulation is quite impossible here, you see, because the State laws control the corporations and the Federal Government levies the tax.

Senator KING. Only the Federal Government, if you will pardon interruption, would have power to classify the corporations, and it might provide a purely arbitrary classification with a view to getting revenue.

Mr. MAY. It would not have the power——

Senator KING. I say to levy taxes on one class of corporations different from the taxes on corporations coming within another category.

Mr. MAY. Yes; but there are, say, 350,000 corporations in the country making returns; they shade off from one classification into another, from a public corporation like the Pennsylvania Railroad down to the corporation that is simply Mister So and So, incorporated.

There is no logical place where Congress can make a distinction because it has not got power to say what kinds of people shall form what kinds of corporations. Therefore any lines that they drew would necessarily be arbitrary and you would find that people would soon get themselves on the right side of the arbitrary line to suit their business. You will do a lot of harm to people by these arbitrary rules; arbitrary rules always do a lot of harm to people they are not intended to reach, and the people who are vitally interested find some way of putting themselves on the right side of the line. That is my experience.

The real basic fact, as I see it, is that you are, if I may use this as an illustration—you are like the juggler trying to keep three balls in the air at once. It is not a question of which holes they fall through—unless you are a very skillful juggler you are apt to find yourself in a position where you can't do it. At the present time you have the 6 per cent normal tax, and the 12½ per cent tax, and the 50 per cent surtax.

Senator COUZENS. Is it not entirely possible to tax holding companies on a surtax basis.

Mr. MAY. What is a holding company?

Senator COUZENS. A company that is not an operating company, a company that holds securities and receives dividends such as was done possibly in the oil cases, where Mr. Sinclair formed the Hyva Co.; companies that receive the dividends on their holdings by means of which they are subject to a corporation tax of only 12½ per cent whereas if they received their returns individually they would be assessed at the surtax rate.

Mr. MAY. Theoretically that is possible. If you would avoid it you have got to make a practically definite law for each corporation. As it is any man within the letter of the law, the scope of the law, must be taxed however inequitable it may seem; and if he is outside the letter of the law he must escape, however just it may seem that he should be taxed. Bearing that in mind, the moment you start modifying the law they start too, and manage to just keep outside your limit all the time.

Senator COUZENS. Would you say for instance that this Hyva corporation kept outside of the limit; that it was formed for the purpose of receiving the dividends?

Mr. MAY. It might buy a corner grocery store; it might operate that——

Senator KING. Or run a chicken ranch.

Mr. MAY. Then you may bring forward the argument that the percentage determines; but they will keep just beyond the percentage.

Senator COUZENS. Suppose you formed a corporation to hold securities in another corporation where that is not prohibited by State laws—for example, in Michigan one corporation can not hold stock in another corporation—assuming that the law provided that all income received by a corporation from securities of another corporation paid the same rate of income tax as the individual, would not that catch these fellows?

Mr. MAY. Then you have the case of a corporation that can not own real estate in another State and has to form a corporation in the State to hold it. It is an absolutely legitimate business proposition and yet would be hurt. The real danger in your proposition is that your fire scatters, and the man who was trying to dodge will get to cover and a lot of other people standing out in the open get hit, people that you are not aiming at at all. That has always been the fact with nearly all of these attempts to distinguish arbitrarily between the treatment of different corporations, or anything else.

Senator COUZENS. I must confess I do not catch your real estate example.

Mr. MAY. Take railroads, for instance, the railroads have to form corporations in different States to operate their lines in those States. The income from those lines should be taxed as individual on this theory—of course you might exempt railroads, but the same is true with a lot of corporations.

Doctor ADAMS. What would you think of using the indirect effort proposed by the Senator—where you can not tax the undistributed profits of the stockholders in some way directly you can do it indirectly by penalties and so on?

Mr. MAY. But there is another point that is involved in that at this time when employees' stock ownership is extending so rapidly. This whole question of undivided profits creates a great problem there because the interests of two groups of stockholders in the same company are radically different. It is to the interest of the small stockholders to have the surplus distributed rather than pay the undistributed profits tax, but the large stockholders say: "Oh, well, we can very well afford to pay that tax rather than have to pay surtaxes;" and the result is that the small man is carrying a burden that is intended to be an indirect burden on the big man.

Senator KING. You mean——

Mr. MAY. If you tax undistributed profits it falls on the little fellow as well as the big fellow.

Mr. GREEN. Is not the English method more or less arbitrary?

Mr. MAY. It is based on a different principle.

Mr. GREEN. Then they have an adaptability that we do not have.

Mr. MAY. They have an adaptability that we do not have in changing it to fit the situation. If they find a taxpayer has evaded it they can instantly pass a law to meet his case, whereas in this country the situation from a legislative standpoint is different. There they have no constitutional limitations and they have all the internal legislative powers consolidated in the one government; they can fit all their administrative measures together to control corpora-

tions and everything else, and they have no constitutional limitations that require them to respect capital or anything else.

Senator KING. Is it not a fact that the administrative tax law in Great Britain contains remedies which can be used in rather an arbitrary way; is it not flexible enough to provide remedies for proceeding against corporations which have evaded the spirit of the law but not the letter.

Mr. MAY. There is a great deal more flexibility in its administration.

Mr. GREEN. That is quite true as applied to England, and the law itself gives these officers discretionary powers which we probably could not give under our Constitution.

Mr. MAY. I was keeping apart from the administrative advantages it possesses. They have a law that is very simple and its administration is the result of the long growth of years. They have established this system of local commissioners which steps in between the taxing authority and the taxpayer and decides these cases something like the Board of Tax Appeals here.

Mr. GREEN. Ony it is decentralized.

Mr. MAY. Only it is decentralized. A man will take his case to the special commissioner where the case is judged, and authorities abide by the commissioner's decision because it does not set a precedent. Mr. Mellon asked me last year—gave me a letter of introduction—to look into this matter and suggested that I could make a report to him afterwards on some of these things which I have in mind; and I went into them fairly thoroughly; and they say that they find that these local commissioners could deal with hard cases very effectively; the parties will accept the decisions of the local commissioners because, as I say, it does not provide a precedent; they think it is a meritorious disposition and they do not appeal it. At the same time that does not bind them to that principle as a precedent.

The CHAIRMAN. It is just a question of flexibility in administration?

Mr. MAY. That is it, together with very long tradition; they have these groups of highly respectable people willing to serve free of charge as local commissioners for the prestige and so on.

Mr. GREEN. You were speaking a moment ago about the tax on undistributed profits being much harder on the small man than on the large investor. In what way did you consider that?

Mr. MAY. Well, if the profits were distributed he would not pay any tax, but if the whole of the undistributed surplus is taxed his proportion of it, his tax, is at the same rate as the tax of the rich stockholders proportion and, therefore, it seems to me that such a proposition would provide the posibility of friction between two groups of stockholders. The employee stockholder is a thing which has been largely devloped as solvent for some of our industrial problems. I would not like to put any grit into a solvent of that kind if I could help it.

Senator KING. Would not we aid the attitude and desire of the small stockholder by imposing a graduated and rather heavy tax upon undistributed profits above a certain and reasonable, and, indeed, a generous allowance as a reserve for contingencies which might arise in the business?

Mr. MAY. Personally I do not think that that would be a wise measure; I mean it is so difficult to say what is reasonable. What would be generous for one would be inadequate for another; and any arbitrary rule could not fit any considerable number of cases at all equally well. I think there must be better solutions of the problem than that.

Senator KING. Well, Mr. May, that question will confront our local chairman here and the committee of which I am a member within the next 24 hours, possibly to-morrow morning, and if you have written any paper on that——

Mr. MAY. Undistributed profits?

Senator KING. Yes.

Mr. MAY. I do not think so.

The CHAIRMAN. You said there was some better way to handle it?

Mr. MAY. I said I think there must be some better way to handle it.

The CHAIRMAN. If there must be, do you know what it is?

Mr. MAY. Well, I will not undertake to say now. I know a little about the subject, but I do not want to create the impression that I am handing out panaceas for all these troubles.

The CHAIRMAN. You have been dealing with the question a long time.

Mr. MAY. I would be very glad to stay in Washington and sit down and talk it over with you.

Senator KING. If you have any ideas on the subject which you would be willing to give us we would be very glad to hear from you and also later for you to give us your mature judgment on the matter.

Doctor ADAMS. You are making that 6¼ per cent in there applicable not only to the undistributed profits, but to distributed profits as well; and if twice as much is distributed as is reserved, that means on the basis of undistributed profits, you have got really a tax of in the neighborhood of 18 or 20 per cent.

Mr. MAY. I think there is a great deal of misapprehension with regard to that question of——

Senator KING. Take a case like this, Mr. May.

Mr. MAY (continuing). Undistributed profits.

Senator KING. Take a case like this: Some large manufacturing institution whose profits amount to millions and tens of millions, if not hundreds of millions of dollars, and the stock is held in the hands of a few, say in a family; they do not declare dividends; it is all undistributed profits, from which they make capital investments of enormous proportions. Do you not see that they are escaping taxation while building up enormous business enterprises without paying any capital tax except the 12 per cent?

Mr. MAY. But personally I do not think that is the fact with undistributed profits of all that class of corporations.

Senator KING. No; because you get the advantage of capital investment.

Mr. MAY. And I do not think these statistics, as I recall, although I have not got them with me—but I think the statistics will show that during the period of high taxation the percentage of distribution of profits was larger than in the preceding period; that taking corporation returns as a whole there is nothing to suggest that more profits were being retained in the business relatively now in the period of high taxation than there were before.

Senator KING. Ford retains practically all of his——

Mr. MAY. You can have a few specific cases——

Senator KING. Of his profits.

Mr. MAY. But taking them by and large you will find my statement sound.

Doctor ADAMS. You have made some study of it, as I recall it?

Mr. MAY. I think I have and I would be very glad to give the committee the advantage of it.

Senator KING. We will be very glad to have you do it.

Mr. MAY. I started out with the conception that there must be less distributed now than formerly proportionately; I think we are all apt to be unconsciously influenced unduly by a few specific cases that come under our notice; but when I got the figures they seemed to me to show quite the reverse.

Doctor ADAMS. Yes; I recall your figures.

Mr. MAY. It showed quite the reverse situation, which was very surprising to me.

Mr. GREEN. Some general statements were made before our committee along the same lines that you have just now mentioned. Of course the particular cases that you speak of when all taken together are so numerous that many of us consider it a very serious question that people who are making such enormous incomes as Mr. Ford, for example, almost entirely escape the individual income tax.

Mr. MAY. Yes; but there is a very grave question as to who is going to be the ultimate beneficiary of that. After all, Mr. Ford can not take very much of it with him when he dies, and the actual wealth he is creating is going to be more valuable to the United States than it is to him; and there is one great disadvantage——

Mr. GREEN. The question arises with us whether Mr. Ford is creating this wealth any more than the laborers who work in his factory.

Mr. MAY. That is another question.

Mr. GREEN. And the community, the farmer who works out in my State and buys the automobiles, who has created the wealth to pay for the automobiles—but that is getting far afield from the taxation question.

Mr. MAY. Yes; but there is the other case of the newcomer in industry who is absolutely dependent on accumulating his profits to expand his industry; and if you put a heavy tax on undistributed profits you are putting the excessively strong people at an advantage and putting a handicap on the invader, the man who is competing with him. That is a very strong argument I think against it.

Senator COUZENS. Take a big store, for instance, like the Wanamaker department store, practically owned by the Wanamakers. They go ahead and accumulate their profits year after year and do not distribute them knowing that eventually the surtaxes are coming down; probably if Mr. Mellon's recommendation is concurred in there would be a cut from a maximum of 50 per cent to 25 per cent—they accumulate these profits over a period of years and when this reduction comes from 50 per cent to 25 per cent they distribute the cash. Do I understand you to mean that you do not believe people in such a case should be assessed anything for undistributed profits during those years where they held up the money waiting for the surtaxes to be reduced?

Mr. MAY. It would annoy me very much that he should escape just taxation, but I would really feel it would be cutting off my nose to spite my face if I tried to pass a general law to reach him. That is my feeling about it.

Senator COUZENS. But there is a general law which would reach him, but the bureau has not exercised it?

Mr. MAY. I do not think there is much scope for the application of the present law to the progressive business enterprise. Most of those are putting their money really legitimately into the business itself, while the private corporations could be reached by section 220.

Doctor ADAMS. If I may interrupt once more I would like to ask you, Mr. May, if there is any difference essentially between the two: that is to say, if earnings are accumulated the stockholders in the indirect sense escape surtaxes, whether they are accumulated in a holding company, an investment company, or a manufacturing company, do they not?

Mr. MAY. Yes; but I think the accumulation of surplus that is devoted to the building up of great industries all over the country is indirectly doing enough good to the country to be compensation for the loss of tax. That is the way the industrial field of this country has been built up, and there is a lot of room for expansion; and I do not want it to be limited to those corporations that are already strong.

Senator COUZENS. I think that you evade the issue. I do not think you do it intentionally, or with any idea of disrespect. It seems to me there must be some way to collect taxes from those who put their profits into bonds, securities, and hold it there until the surtaxes are reduced; I do not understand that he is using it all in his effort to build up industry.

Mr. MAY. That is true, but it is a difficult administrative proposition, and personally I think that in the long run the solution will be to reduce the surtaxes and stimulate distribution rather than levying an undistributed profits tax that would necessarily be arbitrary; and while imposing a perfectly reasonable tax in a lot of cases would be an unfair handicap in a great many others.

Senator COUZENS. I can see a great deal of difference between a concern that uses its suplus profits for expansion and one which holds it in cash or securities that are readily convertible.

Mr. MAY. Yes.

Senator COUZENS. I think there is a very clear distinction between those two that ought not to make it very difficult to administer.

Mr. MAY. Well, of course, it is all a question of degree. They should hold a reasonable reserve in liquid resources. It is the old question that what is reasonable for one quickly becomes unreasonable for another. It is a difficult administrative feature. I do not think you can safely lay down hard and fast rules of limitation.

Senator COUZENS. The law is on the statute book, but it is not being enforced.

Doctor ADAMS. Let me ask you, Mr. May, this question: Do you believe that a statute prohibiting employees of the Bureau of Internal Revenue from practicing say within two, three, four, or five years after resignation or dismissal would be of effective worth, or any real remedy for some of the abuses that have been discussed; and would it be just and fair?

Mr. MAY. What do you mean by "practice"?

Doctor ADAMS. Well, appearing before the bureau, or even by assisting taxpayers.

Senator KING. Or soliciting for others who were practicing.

The CHAIRMAN. Directly or indirectly.

Mr. MAY. Well, of course, if you make it as far-reaching as that it might be effective. If you merely prohibited appearance before the bureau it certainly would not be effective because some of the most conspicuous cases, my impression is, are those cases where perfectly respectable people have the direct work of settling the income with the bureau but someone behind the scene who does not appear in Washington prepares the papers to be sent down by the taxpayer; and I think the bureau is naturally sympathetic for the taxpayer who appears in person, or by his attorney; so that unless you made that apply to rendering assistance to taxpayers it certainly would not be effective.

Personally I think it is very questionable whether it would be fair or reasonable after all. You do not pay these people while they are in the service sufficient to enable them to retire on a competence when they leave the service; and if you want to encourage them to stay for a considerable length of time if you can, and if you had them for any considerable time, you are taking away their best asset for earning a living after they get out; so that I think you might reasonably say that anybody who left the service within a short period after his employment should be prohibited from practicing, but not a man who has rendered real legitimate service to the bureau. I think it would be unfair to put greater restrictions on him than representing organizations of whose cases he had knowledge or was connected with while he was in the bureau.

Senator KING. Of course it would mean whether he had been connected with the case directly or indirectly.

Mr. MAY. Yes.

Senator KING. That came under his cognizance in the bureau.

Mr. MAY. That is entirely reasonable, of course.

Senator KING. How would it be to restrict him from taking any case that was in the bureau, whether he knows of it or not, during the period of his service?

Mr. MAY. During the period of his service?

Senator KING. During the period of his service whether he has knowledge of it or not.

Doctor ADAMS. That would appear unreasonable to me, as a suggestion.

Senator KING. How is that?

Doctor ADAMS. He would have to wait a long time until new cases came up.

The CHAIRMAN. He would have to wait until the next tax year, one year, that is all.

Mr. MAY. I should think that was a little drastic. Personally I feel that if you were going to put on any limit at all it would be against those people who left the service after a short time, those people who gain the reputation of merely going into the service to get information to get out with.

Senator COUZENS. A great deal of criticism has come to me concerning the unpublished rules in the bureau being taken advantage of by these employees when they go out. Have you anything to say in that connection?

Mr. MAY. That undoubtedly must be so, naturally. I do not know how extensive it is. I do not know how many cases there are. I have not heard of very many rules that were not published, but it has not occurred on any vast scale, at least not enough to make any impression on my mind; but, then, of course, I am not in touch with any sources that might know about rulings that had been made in general principles that are not published. If they exist, I do not know of them.

Senator COUZENS. You do not know of a lot of unpublished rules?

Mr. MAY. No; I do not. I have no reason to think that there are a large number; you see or hear of one occasionally, but it has not occurred in my experience on any scale as to impress itself in my mind as a great feature.

It is not so much the rules, I think, as it is the spirit in which the rules are applied and what is within a reasonable this, or a reasonable that. The people inside have knowledge of how the rules are, in fact, applied; that is what made it valuable to them, and I do not think you can publish them without probably doing more harm than good, because what is considered as reasonable in one case depends on the facts of that particular case. As soon as it is published it would be taken as a minimum allowance by taxpayers in future cases. They do not point out the reasons why they are entitled to less, but endeavor to point out various reasons why they are entitled to more. Of course, it is a very great question about the publication of the rulings, I suppose. It is the English practice, as you probably know, to give out very little information about their rules of practice.

Senator COUZENS. Do you believe in the publication of income tax? Not the publication of them, but the records being made public property?

Mr. MAY. I do not know; I imagine my natural training and bent of my mind would be opposed to a general suggestion of that kind, but I think there is a great deal of merit in the suggestion for a reasonable degree of publicity in regard to the results of contests and that sort of thing. I do not know quite how far I would go, but when questions arise in the bureau I think there is a good deal to be said for publicity there because there is a lot of heart burning and dissatisfaction on the part of people who think they did not get the proper treatment.

Senator COUZENS. Do you believe in the establishment of the board of appeals consisting of 27 men provided for in the revenue bill to review these cases?

Mr. MAY. I am strongly in favor of the general principle of a board of appeals that is independent of the assessing end of it. I was strongly in favor of that.

Doctor ADAMS. Is it not your understanding that those 27 or 28 men, if appointed, will replace a substantially equivalent number now serving on the committee of appeals and review?

Mr. MAY. I should assume they would; I should think in the long run they would replace more, because they ought to be able to get through their work. Being in a stronger position, having definite responsibility I think they would be apt to work with a great deal of promptitude and more efficiently.

Doctor ADAMS. In its essence this proposal is not for something additional, but a substitute?

Mr. MAY. I should think it ought to reduce expenses.

Doctor ADAMS. With the chairman's permission, I would like to interrupt once more to ask one more question: Your feeling that it would be unfair and too drastic to prohibit employees from practicing would not apply to a situation in which people holding certain important posts were given larger and more adequate salaries with the understanding that the employee in accepting such salary should not enter private practice for a considerable period after he left—you would not have the same feeling toward such a proposition where this was understood in advance?

Mr. MAY. Oh, no; no; of course not.

Doctor ADAMS. I think that has got to be considered by the committee very carefully and I wanted to bring that point out. There certainly could be no charge of unfairness with such an understanding in advance.

Senator KING. I understood you to state, Mr. May, that in most of the instances that have been brought to your attention directly or indirectly, is the cases of employees of the department interviewing your clients or others they have in most instances stated definitely what the assessment was to be?

Mr. MAY. Oh, I would not say in most cases. I have heard of a number of such cases; I would not say at all that that was the general practice. There have been a number of such cases mentioned to me, but I would not say that the number was large enough to indicate a general practice, as far as we are concerned.

Senator KING. They would not be able, of course, if they were not in the department, to know what the assessment was going to be, what the tax was going to be, unless they had a confederate in the department?

Mr. MAY. I should think so; I do not see how they could unless they had a confederate somewhere.

Senator KING. Have you any suggestion to make as to the method of dealing with Government employees and the question of their practicing before the department; what concrete suggestions would you make?

Mr. MAY. Well, I think the only restriction on the general line I would make would be a fairly drastic restriction against, as I said, practice in the case of people whose service in the bureau was short, people who resigned after a comparatively short period of service. That is the only direct restriction that I would make. I think a more drastic restriction than that would be unfair. I think the rules of practice they have got now, if they can be enforced, are fairly good.

Senator KING. Is it not obvious from the large number who have gone out from the department, and who are practicing, that many of them, or that some of them, went in only for the purpose of getting information?

Mr. MAY. Yes; I have no doubt it is.

Senator KING. That they might go out and practice?

Mr. MAY. I have no doubt it is.

Senator KING. That they are willing to profit——

Mr. MAY. Yes.

Senator KING. And exploit the Government?

Mr. MAY. One of the best ways to get rid of that situation is to clean up the old cases; if you get the 1917 cases out of the way, particularly under invested capital for 1918, the opportunity for these people would be so restricted that the abuse would no longer be a major abuse, if it continued.

Senator KING. There would be a diminution in the number of practitioners.

Mr. MAY. There would not be enough to go around.

Senator KING. The pickings would be smaller.

Mr. MAY. The pickings would not be good enough; that is right.

Senator KING. Mr. May, I have heard many complaints about the enormous credits and deductions and allowances for amortization, for depletion, for deterioration, for repairs, etc., and I have called attention upon two or three occasions here to the evil which seems to us exists especially in real estate in large cities, apartment houses, and other buildings in large cities because of this: Values have increased instead of going down during the past few years, and they get their annual depreciation, deductions, notwithstanding there have been enormous accretions not only in the land, but in the property; those buildings that could be built for one hundred thousand dollars 10 years ago could not be built for three or four hundred thousand dollars in many instances to-day; and they were built better then in many instances than they are built now; and yet they are getting depreciation, although the fact is that the buildings are worth two or three hundred per cent more than they were when they were constructed, or than they were a few years ago.

Have you any suggestion to make as to how to meet the difficulty of amortization, depletion—especially oil wells and mining properties?

Mr. MAY. Well, on your first question if you refer back you will see that the 1909 statute talked about depreciation generally, and the 1913 statute in the cases of corporations, as I remember, retained the word "depreciation" but said, "arising from the use, or wear and tear of property employed in the business." In the case of individuals the word "depreciation" was not used; it is simply "use, wear, and tear."

Now, my recollection—I had a little to do with it—and certainly my recollection is that that was a deliberate action on the part of Congress to distinguish between fluctuations in value due to outside causes and the gradual exhaustion of value due to inherent characteristics of the property. They said, "We will take no notice of fluctuations up or down in value due to extrinsic causes; we will only allow you for the inevitable fact that ultimately the property will disappear."

Now, your case of the fluctuation in value of real estate is a fluctuation due to extrinsic causes. That stands on an entirely different footing from the allowance for the gradual exhaustion of the property itself.

The legitimate offset to that is fluctuation downwards of property due to extrinsic causes. Neither of those come within the purview of the statute. So I do not think the fact that by reason of extrinsic conditions the property is appreciated has a bearing on the reasonable allowance for depreciation on the theory which the law is now framed, and which I believe is the right theory.

Senator KING. Then they allow too much for depreciation?

Mr. MAY. I think possibly they may have in a great many cases for depreciation as depreciation; no doubt they have, but personally I think in the war there was a lot of unwise expenditure; and I question whether in the aggregate that appropriate deductions have been very much greater than they should have been. I think on the whole they have been allowed too much, but I do not think that is a major evil, and I think the attempt to remedy it now would do more harm than good because it is only really important in the very high tax years. At the present stage the tax on the difference in depreciation is not a major factor at all.

Senator KING. What do you say as to amortization and obsolescence?

Mr. MAY. Amortization of war facilities is an almost insoluble problem. As far as my office is concerned, we have tried to wash our hands of it as far as possible. We have never seen a satisfactory rule for us to follow and we relegate that to engineers as much as possible. We have preferred to keep out of that. I have never found a very satisfactory measure of it; we were not altogether satisfied of its soundness, and I have thought we had enough problems that we were trying to find some solutions for and that we could leave some to others.

Senator KING. In the interpretation and in the application and administration is it not a fact that allowances have been given for amortization that have been so large as to practically reduce the tax to a minimum?

Mr. MAY. I have heard people claim so, but I do not recall any single case where I have got definite figures that would enable me to say so. I have heard of two or three amortization engineers claiming that they have done that; but I have not gone into those questions, as I stated, with anything like the care that I have into some of the other problems.

Senator KING. Have you had anything to do with depletion?

Mr. MAY. I have had a certain amount to do with depletion of ores rather than oil. Oil is an engineering problem. I have never fathomed the calculation of oil depletion myself.

Senator COUZENS. Is there a Mr. Brown here?

Mr. BROWN. Here, sir.

TESTIMONY OF CHARLES F. BROWN, BROOKLYN, N. Y.

(Mr. Brown being called as a witness, was duly sworn by the chairman and testified as follows:)

Senator COUZENS. Give your initials and your residence to the stenographer, Mr. Brown.

Mr. BROWN. Charles F. Brown, New York City; 376 Franklin Avenue, Brooklyn, N. Y. That, however, is only temporary.

Senator COUZENS. You are a former employee of the bureau?

Mr. BROWN. I was.

Senator COUZENS. Will you tell us when you went into the bureau and when you left, and what positions you occupied in the bureau.

Mr. BROWN. I was appointed as an appraisal engineer on November 3rd, 1921 and assigned to the Income Tax Division. Any further questions, Senator?

Senator COUZENS. Did you occupy that same position all the time you were there?

Mr. BROWN. Yes.

Senator COUZENS. And when did you leave the bureau?

Mr. BROWN. Why, I had notification, which I received very much to my surprise, on July 2, from ——

Senator KING. What year?

Mr. BROWN. Signed by J. G. Bright, deputy commissioner.

Senator KING. What year?

Mr. BROWN. July 21, 1923. There had been rumors in the department that there was to be a big reduction in the engineering force due, they claimed to the current condition of the work and the current condition of funds. In other words, that was what they wanted understood; and even to this day that amortization is a proposition that is practically unconcluded, as this gentleman here stated a few minutes ago. It is one that is going to continue for a number of years to come.

However, this letter that I received was, as I say, from Mr. Bright, deputy commissioner:

SIR: I regret to inform you that the Secretary of the Treasury has approved the recommendation of the Commissioner of Internal Revenue that your service be discontinued on July 31, 1923, on account of a necessary reduction of the force of the Income Tax Unit, owing to the reduction of the bureau's appropriation for the current fiscal year and because the work of the amortization section is nearing a current condition.

This action has been taken after a very careful consideration of the efficiency ratings, conduct, reports, and attendance records of all members of the unit.

Unused annual leave accrued to your credit since January 1, 1923, will be allowed you if it is applied for immediately in the usual manner.

J. G. BRIGHT, *Deputy Commissioner.*

Now, when I got this letter I went up to a Mr. Kane, who was next to the head of the amortization section, and apparently six other engineers received a like letter.

I said: "Mr. Kane, what does this mean?"

"Why," he says, "I don't know," he said; "I don't know anything about that."

I said, "What shall I do?"

He said, "Take my advice and go over and see Deputy Commissioner Bright."

So I went over to see Mr. Bright and I found that he was busy in a conference. Then I went in to see Assistant Deputy Commissioner Allen, who told me that I had come to the right party, as he had charge of those matters.

I said, "Mr. Allen, what does this letter mean?"

"Why," he said, "Mr. Brown, that letter was a mistake; that should never have been sent out; none of the engineers should be let out upon charges. As a matter of fact we had plenty of work for them to do even if the amortization feature goes out."

The CHAIRMAN. Who was it said this?

Mr. BROWN. Mr. Allen, assistant deputy commissioner. He said, "We are advertising for engineers now." That was a fact—"for valuation engineers;" and yet they say they can not retain the force because owing to the current condition of funds. So then I said, "Well, why go to work and pitch me out, an old employee, pretty near two years in the service; why kick me out over the heads of 20 new engineers?"

And he says, "Well, Mr. Brown," he said, "your name was put on the list as being available to let out."

Whereupon I made certain charges. I intimated that it was all the result of personal animosity on the part of my immediate superior as to the reasons for my name appearing on that list.

The CHAIRMAN. And were the charges in writing, Mr. Brown?

Mr. BROWN. I will come up to that if you please in a minute, Mr. Chairman.

The CHAIRMAN. All right.

Mr. BROWN. So he says, to me, he says, "Well, Mr. Brown," he says, "those are very serious charges;" and he says "I will have this investigated, and if they can not be proven," he says, "it will not only mean your dismissal from the service, but your expulsion."

I said "Well, Mr. Allen", I said "Supposing it is proven, what I say is proven?"

He says, "Then you will be reinstated immediately."

I want to say I came down there on the following day with these charges, and they were given, as I understand, to a man by the name of Helex, who, I also understand, was the means of getting the chief of the section, S. T. De La Mater, his position in the department, and they were personal friends, had known each other out in Chicago or thereabouts.

Senator COUZENS. Who did you make these complaints to?

Mr. BROWN. To Mr. Allen.

Senator COUZENS. Is he still in the service?

Mr. BROWN. Oh, yes; he is assistant deputy commissioner.

The CHAIRMAN. And who was your chief there?

Mr. BROWN. S. T. De La Mater.

The CHAIRMAN. De La Mater?

Mr. BROWN. S. T. De La Mater. Capital D-e, capital L-a, capital M-a-t-e-r. And so this thing was given to him, as I say, to investigate. He went down there and, I presume, said, "Hello, Stephen; what about these charges of this man Brown?"

"Oh, nothing to it, nothing to it." And then they went to work and they wrote up a letter.

Senator KING. Mr. Brown, pardon me, have you got the charges there that you preferred?

Mr. BROWN. I have.

Senator KING. Are they available for the committee?

Mr. BROWN. They are, sir; any papers that you might wish.

Senator KING. You better let the chairman see them and determine as to whether they ought not to be put in the record.

Mr. BROWN. I might say these papers are copies; the originals are in the hands of the Bureau of Internal Revenue, aside from those letters that might be in the hands of the Civil Service Commission.

The CHAIRMAN. Does this have reference to the conduct of individuals?

Mr. BROWN. It does, sir.

The CHAIRMAN. It does not have any reference to tax matters?

Mr. BROWN. It simply cites different cases of engineers which they had handled especially in regard to new engineers that had been put on tremendous big cases that had only been in the office a very short period of time.

The CHAIRMAN. Well, I think it is all right to read them; read them to the committee—read the charges.

Mr. BROWN. This is data for Mr. Allen, assistant deputy commissioner, concerning W. B. Jennings.

I hereby charge——

The CHAIRMAN. This is the first charge you made in full?

Mr. BROWN. This is charge No. 1 that I made:

I hereby charge W. B. Jennings with incompetency, bias, and partiality in the supervising of the engineering section of the Income Tax Unit—I. T.; S. A.; A. M.—

Those are initials of the section—

basing my statements upon the following facts:

1. Jennings said seven or eight months ago, this in front of a number of engineers at the office, among whom were Messrs. Kahn, Besse, Bowling, and others, including myself: "The chief and I have agreed that there are only three or four men in the whole section who are capable of handling large cases." The fact is that small cases have all the complications and require the same care and study that larger ones do, it being only a matter of adding ciphers, and a few more pages of descriptive matter to one's report.

"By said statements, as outlined above, he was injuring the morale of the section.

We had a section of engineers consisting of about 30 or 40 men, and to have a man to get up, who is supposed to be your immediate superior, and say: "The chief and I have agreed that there are only three or four men in the whole section who are capable of handling large cases"—why, many of those engineers there were men of renown, in fact, men who were members of high standing in their engineering societies both as civil, mechanical, and electrical engineers—but we will come to the standing of this man Jennings in a moment—the man who made such a statement as that.

No. 2. Favorites were given cases in or near their home town or places they wanted to visit, but when I was being assigned out on some cases to New York City, I wanted to get a case near Boston on account of my brother being on his death bed—

Captain, Aviation Corps; he is under the sod to-day—

Mr. Jennings informed me that the "highbrows" up in the front office would not stand for it, as there was now an engineer in the New England field.

At the time I made this request I knew there were in the office at the time three cases in that vicinity, none of which exceeded $75,000, and one of the three was an expedite case, and as to another engineer from this section being in this territory at the same time, the one previously assigned, that only last week there were two men in the same city on different cases, and this has occurred frequently.

The term "highbrows" seems to be a favorite expression of his when referring to his superior officers, as he has used same quite frequently, thus showing disrespect or gross ignorance in the premises.

No. 3. He never gives a decision on any question, but refers it to others.

No. 4——

The CHAIRMAN. That is Jennings?

Mr. BROWN. Yes.

Mr. Jennings put a new engineer on the large case of the Colorado Fuel & Iron Co. who was so ill-informed—knew at the time that this engineer's case, when turned in as finished, was without a summary sheet.

The CHAIRMAN. Do you know his name?

Mr. BROWN. I prefer not to give it to you, if you please, sir.

The CHAIRMAN. What do you mean by a summary sheet?

Mr. BROWN. The summary sheet is simply the summing up of the whole thing; the crucial part of the whole claim is right in the summary sheet.

When this case was presented to Mr. Jennings for review, he referred it to Mr. Luce, an assistant engineer, on a Saturday with a request that he look it over and see if it was all right for him, Jennings, to sign, stating at the time: "You know more about such cases than I do."

On the following Monday he asked Mr. Luce if the case was all right for him, Jennings, to sign, whereupon Mr. Luce said it would take at least three days to properly analyze it, and that he did not intend to give any snap judgment. At this remark Jennings became incensed and said: "Well it looks all right to me, and I'm going to sign it."

Liberal allowance on this case has caused much comment in and out of the office, being brought to my attention by an official of the Pocahontas Fuel Co., who stated at the time that he hoped I could be as lenient in their case as was the engineer in the above case.

The CHAIRMAN. That is the Colorado Fuel Co. case?

Mr. BROWN. The Colorado Fuel & Iron Co.

No. 5. Another engineer's report on the National Carbon Co.'s case was criticized by Engineer Flournoy, but he said he would sign it, as he did not like to criticize an older engineer's work, although he knew that the allowance made in this instance by the said engineer was too much.

Senator KING. Is that "said engineer" in the service now?

Mr. BROWN. He is, sir.

Prior to this case coming before one of the review engineers, I mentioned this fact to him and suggested he be on the lookout for it, whereupon he thanked me, and thus was brought about a reduction in a considerable amount by this reviewing engineer of the erroneous allowance.

Mr. Diemer also allowed amortization on replacement costs for building construction when the department ratios clearly show that buildings can not be constructed as cheaply to-day as in the years 1917 and 1918. See this engineer's report referring to claim of White Ash Coal Co. case.

Doctor ADAMS. What was the case in which the allowance was made of the construction cost?

Senator KING. National Carbon Co.

Mr. BROWN. National Carbon Co.

See this engineer's report regarding claim of the White Ash Coal Co. case, which, upon a redetermination, at taxpayer's request on the part of another engineer, this allowance improperly made by a supposedly A No. 1 engineer, and whom Mr. Jennings so classifies this particular friend of his in his production records was disallowed in its entirety, yet the said engineer is secure in his position on account of the said friendship existing between the two men, while other engineers not so incased are recommended for dismissal, regardless of the fact that no such errors have been made in their work.

6. When Mr. Jennings was reviewing, he allowed cases to accumulate on his desk and instead of working to catch up, he called Mr. Luce and said, "Larry, I am going away on some cases and when I return I want to have all these reports on my desk reviewed, and don't want to see any of them here when I return."

Mind you, he was the senior reviewing engineer; that was his business, and this Larry was an assistant engineer; he was not a reviewing engineer.

Senator KING. Larry?

Mr. BROWN. That is his first name—Larry Luce.

Senator KING. Luce?

Mr. BROWN. Luce.

Thereupon, Jennings went away to investigate cases as an appraisal engineer, and was absent over a week, with Mr. Luce in charge of his, Jennings's work, which the latter was supposed to perform in connection with his duties, to which he was advanced, to the position of reviewing engineer.

No. 7. The writer in connection with Engineer Schwaren recently was informed by him that Mr. Jennings could be made a deputy commissioner if he were to ask for it, as he had such good political influence back of him.

Senator KING. Who said that?

Mr. BROWN. Mr. Schwaren, one of the engineers, told me.

Senator KING. That is his given name?

Mr. BROWN. We have a couple of engineers here to-day from the amortization section.

Senator KING. Is Schwaren in the department now?

Mr. BROWN. He is not in the department now.

Senator KING. J. W. Schwaren?

Mr. BROWN. Yes.

The CHAIRMAN. Let me ask, when did you have this conversation with Schwaren?

Mr. BROWN. That was just prior to this order coming out for the dismissal of the first lot of engineers.

The CHAIRMAN. And he then was in the service?

Mr. BROWN. He then was in the service.

Senator KING. That would be June, 1923, because that was in July?

Mr. BROWN. Yes.

No. 8. I had hardly been in the department more than a few months when I—

I think this matter here, that this case, your honor, is irrelevant, and I will leave it out, if you have no objection.

The CHAIRMAN. That is all right.

Mr. BROWN. In this particular instance De La Mater referred to it as office talk. I will accept his definition of it.

No. 9. When the question of reclassification arose, Messrs. Jennings, Bowling and Thwing were appointed reviewing engineers with a corresponding increase of salary. Prior to that time as appraisal——

Senator KING. Bowling—what was the other man's name?

Mr. BROWN. Bowling and Twhing.

Prior to that time, as appraisal engineers, they were occasionally called upon to review cases as were various engineers in the section from time to time, and even though they have received this higher appointment which will materially aid them in the reclassification, they have not ceased to be sent out by the said Jennings on appraisal engineers' work, thus allowing reports to accumulate and necessitating the calling upon other engineers not so designated by the department as reviewing engineers, to perform their work, receiving therefor no credit, and besides drawing far less salary than duly accredited reviewing engineers do.

I think Mr. Clarke can back me up in that, because he has reviewed a number of cases.

The CHAIRMAN. These charges have reference to the time when they were made and not to the present time?

Mr. BROWN. No; not to the present time.

The CHAIRMAN. Not to the present time; is Jennings still in?

Mr. BROWN. No; Jennings was—I discovered that he had falsified his civil-service record. He claimed he had gone through the Providence High School when he never had been there; he claimed he put in a three or four years' course in Brown University, and a letter I have from the registrar of that college said that he never attended there; that his name is not on the books.

The CHAIRMAN. When did he leave the service?

Mr. BROWN. He was fired out of the service.

The CHAIRMAN. When?

Mr. BROWN. I could give you the exact date; I will come to that later.

The CHAIRMAN. That is all right; I just wanted to know.

Mr. BROWN. Because I have followed this thing very closely; I have been at this thing six months now, and I am still on the job, as Mr. Nash knows.

The CHAIRMAN. That is to say fighting——

Mr. BROWN. Fighting for the rights of these 21 engineers who were dismissed on charges of inefficiency gotten up by such a man as that.

The CHAIRMAN. Fighting to be reinstated?

Mr. BROWN. To be reinstated; and we do not care—I do not suppose any one of us—I know as far as I am concerned that they can have my resignation five minutes afterwards; but after having put in the service, after as I have done, served for pretty nearly two years and to have a thing like that gotten up against you and to be thrown out into the world with those charges of inefficiency attached to you; I tell you I think it is wrong; and I do not think our big Government of the United States would stand for a thing like that; I do not think the people intend that their public servants should be treated that way by incompetents.

No. 10. Only a short time ago, Mr. Jennings, while talking to a group of engineers in room 1660, was heard to say in a loud voice:

"That's all Brown's fault, ——— ——— him, anyhow. Oh, no; I should not have said that."

That night I was approached by Engineers Thompson and Donnelly, who asked me if I had had any words with Jennings that day, and I told them that I didn't recollect having had any conversation with him at all, whereupon they told me the foregoing.

This plainly shows bias, and it is this same man that has the formulating of the section production records, and who can vent his likes or dislikes upon whom he chooses to, as, for instance, my case.

No. 11. The writer was called upon to make a reexamination of Kossee, Shoe & Schyler Co.'s case, as this taxpayer demurred to the findings of Engineers Jennings and Munson in regard to their sawmill, whereupon it was found, upon reexamination, that the said Jennings and Munson had allowed the taxpayer the full amount of amortization claimed on their factory building upon the grounds that taxpayer's representative stated that the company was going to abandon the building at the end of the year 1920, leaving a matter of six months to run, whereas this engineer found the company using this building more or less in its going business as of the date of his investigation. This would tend to show conclusively a lack of knowledge on the part of the said Jennings of the rules and regulations, as otherwise this allowance could not have been made.

And I can say, too, that the company tried to appeal this case; they had the firm of Ernst & Ernst—a Mr. Philbrick—come up there with the intention of appealing my report, but I was sustained right straight through.

An examination of the civil service papers of the said Jennings, I understand will show an entire absence of training and experience for the position he holds.

As a matter of fact, the nearest approach he has had which would entitle him to hold a position of this nature was possibly gained as a shop superintendent, bossing a number of mechanics; and further as to the handling in a proper manner as a gentleman and a scholar, as one should be to hold the responsible position he holds, the only training he has had according to said civil service papers evidently came from a further training received while in charge of men erecting steam engines, boilers, etc., together with that outlined above; also that gained while employed as an assistant superintendent of the shop of the Providence Engine Works during the year 1905 at a salary of $2,000, and also as superin-

tendent of the shop of the Easton Machine Co. at a salary of $2,150; and it is this man who has now been intrusted with the overseeing and supervising of the work of from 30 to 40 engineers, all a high-class type of citizens, and who are not in the habit of being treated and subjected to the insulting remarks of one whose former positions undoubtedly necessitated his addressing those under him in terms foreign to those which intelligent men have heretofore been subjected.

In making these acquisition (accusations?) I wish it may be understood that I have never had words with this party or by any act given him cause to accord me the treatment he has; in fact, to quote one of my coworkers whose name will be given in confidence, if desired: "Mr. Brown, what is the trouble between you and Mr. Jennings? Why, do you know that man has talked shamefully about you in the office." My reply was: "I haven't the slightest idea why he should do so."

No. 13. In summing up I feel that I have clearly established the utter unfitness of this man to hold the position he does, and further that the lack of respect shown for his superiors in referring to them as "high brows" should call for a stern action in the premises, if not his dismissal from the service. Respectfully submitted.

This charge is filed in conjunction with my production record which I gave you and for the good of the service a hearing thereon in due course is herein requested.

Senator KING. Was any question raised—answer this "yes" or "no" if you can, to save time—as to your competency?

Mr. BROWN. Why, I do not know why there could be any.

Senator KING. You had had experience before?

Mr. BROWN. Why, before I went into this division I had been in a contracting engineering business of my own for pretty nearly 25 years, and Uncle Sam would never have gotten me if it had not been on account of the war, because the minute we got into the war I tendered my service to the Chief of Engineers and I qualified for a major in grade B, but through the mixing up, or from the lack of proper experience of a young Army officer who was making a urinalysis test, he thought he found traces of kidney trouble, and he only took one sample. That resulted, of course, in my being denied the privilege of going into this engineering department; but afterwards I was taken into the Ordnance Department in the New York district—went there, took the civil-service examination. They advertised for engineers for the Ordnance Department; they wanted to give them a training in ordnance and then put them in as captains in charge of ammunition yards.

Senator KING. That is very interesting, but we are wasting a lot of time; what I am interested in and what my question was is whether you were competent.

Mr. BROWN. Then afterwards, after we got through that, I was made a member of the salvage board and handled the largest claim in the New York district, claim against the United States, which is on the same basis of valuation as we make to-day.

Senator KING. But your only experience, as I understand, was contracting in New York City?

Mr. BROWN. I had been a contracting engineer for pretty nearly 25 years. Prior to that I had been in civil engineering in charge of railroad work for eight years, and I left that to go in contracting.

Senator KING. What kind of work would you do as a contracting engineer?

Mr. BROWN. Electrical, civil, and mechanical.

Senator KING. Did you draw blue prints for the erection of buildings?

Mr. BROWN. No; I did not. I would contract for that work—contracting engineer. In other words, to give an illustration: The Government had an electrical railroad system over on Governors Island, and, usually, of course, we all know that the Government is supposed to be very careful in specifying to the minutest detail in regard to equipment and even specifying the size of the smallest bolt to be used—they had a very fine electric locomotive there but they never took into consideration the curve that was in the rail, so that the flange on the wheel only having a clearance of about an eighth of an inch, when they came to the first curve there wasn't clearance enough and she rode up onto the rail and off into the ditch, and they had a great deal of trouble getting it back on. When they got to the second curve they couldn't get it around there. So they advertised for bids for making changes in the railroad equipment for equipping the cars for haulage by this electric locomotive, by making changes in the locomotive, changing the wheels, or changing the track, or whatever it might be——

Senator KING. That is the character of work you did?

Mr. BROWN. Yes.

Senator KING. The details are not necessary.

Mr. BROWN. No. As a matter of fact I was the only bidder on the job in the whole city of New York. That shows——

The CHAIRMAN. What was your education previous to starting on this, Mr. Brown?

Mr. BROWN. My education—as I say I was in civil engineering for eight years and the latter part of it I had charge of a party of engineers on the Boston & Albany Railroad on the elimination of grade crossings. My education has been gotten through the college of hard knocks. In other words, when I first started in civil engineering I went to a private tutor there in Boston. Then I had a brother who was a graduate of Yale who also helped me through any trouble in that way. I went right up through, from the mathematics right up through into calculus, trigonometry, and the rest of it so that all told my experience has been extremely broad. I do not know of any business that qualifies a man better for such work as an appraisal engineer or anything of that kind than to be a civil engineer in construction on railroads. The duties there are so varied that it gives him a very broad knowledge of all matters.

Senator KING. Mr. Brown, you were requested to give us some information. Now, have you anything to say about the bureau outside of what you have said, which is a matter that the committee can hardly correct.

Mr. BROWN. This matter, as I have gone through in regard to Mr. Jennings, has been the cause of my going right straight through, right up even—it is now in the hands of the Secretary to the President, Mr. Slemp, which, virtually, of course, is the President of the United States. As Mr. Allen told me when I took that letter to him, he said: "I will investigate this thoroughly, Mr. Brown. If you are not satisfied with my findings you have an appeal to the commissioner; if you are not satisfied with his findings you have an appeal to the President of the United States;" and I said: "That is where I will take it, if necessary."

Senator KING. We are not interested in that; we want to know——

Mr. BROWN. I will tell you, Senator, this is a matter having to do with the morale of the section, such things as dismissing com-

petent engineers on such charges. Is that conducive to good work in a section? Is the closing down of a department and throwing out a whole lot of people—people leave at 4.30 in the afternoon; they come there next morning and find a whole department, section, wiped off the map; is that conducive to good work? The men are shifted around from one post to another.

The CHAIRMAN. If that is the complaint you have got to make you better——

Senator KING. I think if they would wipe out a few more bureaus and agencies of the Government it would be to the good of the country.

Mr. BROWN. There is no question about it.

Senator KING. I wish they would wipe out some more.

Mr. BROWN. If they would put some of these political officeholders out of their jobs that are pretty well encased in the different departments of the Government.

The CHAIRMAN. Did you have any difficulty with your superior officers?

Mr. BROWN. I never had any difficulty with any of them. In fact, not being egotistical, I do not think that there was perhaps a man any better liked by his associates than I was.

Senator KING. Was Mr. Jennings fired as the result of this complaint which you made?

Mr. BROWN. He was; he was.

Senator KING. After an investigation?

Mr. BROWN. He was.

Senator KING. And he was fired?

Mr. BROWN. He was.

Senator KING. Were any others fired as a result?

Mr. BROWN. Well, Mr. Delameter was requested to resign.

Senator KING. Any others?

Mr. BROWN. I could not say——

Senator KING. Was Mr. Delameter requested to resign as a result of this investigation?

Mr. BROWN. Yes.

The CHAIRMAN. And was that because of Jennings?

Mr. BROWN. Yes.

The CHAIRMAN. His relation with Jennings?

Mr. BROWN. Yes; because I was up to see the commissioner one night, up to his apartment, I could not see him at his office; they would shift me off every time I went to see him. I said to myself I do not know of any man in the service of the Government, in the service of the people, who is so big that he can not be seen under such conditions. So I went up there and I saw the commissioner at his apartment, as I said. I called up and he said for me to come up, that he was going to the theater, but would grant me a few minutes.

The CHAIRMAN. You had more trouble getting to some of those bureau chiefs than you did getting to a Senator or the President of the United States.

Mr. BROWN. There is no doubt about it.

The CHAIRMAN. And more trouble after you got there.

Mr. BROWN. The bureau chiefs have a beautiful way, Mr. Chairman, of passing the buck.

Senator KING. The trouble with a great many of them is that they are not there.

Senator COUZENS. They do not pass the buck any better than Senators, do they?

Mr. BROWN. When I gave this production record into Mr. Allen he asked me for these things. Here is my production record as appraisal engineer, and I would like for you to take any of this which you want.

Senator COUZENS. We do not want to go into those matters any farther if that is all you have. I thought you had some information which would be of value. I do not think we want to spend any longer time on this.

Senator KING. You have been vindicated.

Mr. BROWN. I have not been vindicated, sir.

The CHAIRMAN. You were fired, and Jennings was fired.

Mr. BROWN. That does not make matters right.

The CHAIRMAN. So you are both out now.

Mr. BROWN. Who?

The CHAIRMAN. Jennings is out and you are out. After you filed these charges against Jennings, how long did you stay in?

Mr. BROWN. I was out then.

The CHAIRMAN. You were out?

Mr. BROWN. Oh, yes, indeed.

The CHAIRMAN. When you filed the charges?

Mr. BROWN. Yes, indeed.

The CHAIRMAN. How long had you been out when you filed the charges?

Mr. BROWN. Oh, possibly—I think just the same day.

The CHAIRMAN. The same day?

Mr. BROWN. The same day.

The CHAIRMAN. And how long did Jennings stay in after the charges were filed?

Mr. BROWN. Just long enough to give the Civil Service Commission in conjunction with the Intelligence Bureau of the Treasury Department, a chance to investigate these charges of mine, which necessitated their going up to Providence, R. I., and other points to find out whether these were the facts or not.

The CHAIRMAN. Was it a short time?

Mr. BROWN. No; it was not, because——

Senator KING. Was it a matter of months?

Mr. BROWN. I would say about six weeks.

The CHAIRMAN. Before you filed these charges against Mr. Jennings you were acquainted with the facts?

Mr. BROWN. No, no; I was not, only as to these things that might have come up in the department as to what we had been doing there; that is, for instance, throwing off all his work on the other engineers to do, never taking responsibility on his shoulders, which he was supposed to do.

The CHAIRMAN. When did you become aware that he had violated the civil service law?

Mr. BROWN. I will tell you how that came up.

Senator KING. Answer directly, please; hurry along; we have not much time left.

The CHAIRMAN. How long before you filed charges against him?

Mr. BROWN. I found out that he had——

The CHAIRMAN. Violated the civil service law?

Mr. BROWN. I should say about three weeks—two weeks possibly; two or three weeks.

The CHAIRMAN. Had there been any differences between you and Jennings up to that time?

Mr. BROWN. Not a bit.

The CHAIRMAN. No difficulty at all?

Mr. BROWN. Not a bit.

The CHAIRMAN. And although you had heard these things about you, you had remained quiescent?

Mr. BROWN. That is it exactly.

The CHAIRMAN. Had he said these things or similar things about other engineers?

Mr. BROWN. He had; yes, sir.

The CHAIRMAN. Now, was there any effort on the part of you fellows who had just been asked to resign to organize to say things against him and clear up the general situation?

Mr. BROWN. No; there hadn't.

The CHAIRMAN. Nothing of the kind?

Mr. BROWN. Nothing.

The CHAIRMAN. Other than to see——

Mr. BROWN. I believe engineers as a rule are above such things.

The CHAIRMAN. We are here just trying to find out what the situation was, whether there was an internal revolution there.

Mr. BROWN. There was on the part of a few, but not in the general run of engineers. There was a clique in there, there is no question about, composed of about five men.

The CHAIRMAN. But you were not in any clique yourself?

Mr. BROWN. No; I was not, sir.

The CHAIRMAN. Is that clique still there?

Mr. BROWN. There are a few of them there at the present time but the people that have been falsifying the statements made here against myself that ought to have been put out and I verily believe they would have been put out if it had not been that the bureau had so far depleted the amortization section that they could not absolutely let them go. As a matter of fact, they cut down that amortization section so greatly that they only here a little while ago they had to call upon engineers in another section to come in and help out the amortization work.

Senator COUZENS. Do you know of any dishonesty in the bureau?

Mr. BROWN. Well, I can not say that I do; no, sir. Somebody said something about that. We had our suspicions, but at the same time those things are done so carefully—you take, for instance, where one man or two men may go out into a conference room and settle a case with a taxpayer, the rank and file are not going to know what is done, as, for instance, there have been a number of cases, very few cases, that have come up on redetermination, when I was not asked to go into the conference room somebody else went in; whether there were fixers or not I don't know.

Senator KING. Complaints have been made to me by quite a number, some in the department, some outside, that in settling important matters the engineer who made the investigation was not consulted and the decision was rendered by the supervisor—I have

forgotten his name—but at any rate those who passed upon it did not confer with the man who knew most about it.

Mr. BROWN. Oh, yes; that was often the case, because in quite a number of instances——

Senator KING. That is especially where it was settled in favor of the taxpayer and against the Government.

Mr. BROWN. Well, that occurs very frequently, because the engineers, the appraisal engineers, were only in the office long enough to complete their reports before they were ready to go out on other cases and were assigned to them. So that it might mean that some of the engineers were away on those cases.

Senator KING. No; but the cases that have been called to my attention were to the effect that the engineers who had made the survey to determine depletion, or amortization, or depreciation, or what-not, when they were present in the service, and in Washington, and the matter was under consideration, were not consulted where their report was in favor of the Government and adverse to the taxpayer, and immediately afterwards, or a short time afterwards, a decision was rendered in favor of the taxpayer.

Mr. BROWN. I have no doubt of that at all, because we had a conferee there and the conferee would assign a certain number of people to go in a hearing of the case, and usually we had some of the engineers there—that that was wholly their attitude, to go into the conference room; and, as I say, that occurred very often where the engineer who wrote up the report——

The CHAIRMAN. Do you know of any specific instance, Mr. Brown, that you can tell the committee?

Mr. BROWN. Offhand I can not say that I do, because——

The CHAIRMAN. Then, of course, the simple fact that a thing of that kind did occur would not necessarily involve fraud and corruption.

Mr. BROWN. No, indeed; but still it is proven that there was one case there where the conferee was dishonest.

The CHAIRMAN. What case was that?

Mr. BROWN. I think probably—it seems to me that it was some Waterbury company where this conferee had agreed, according to—this is what I gathered from the newspapers—in fact, I was away on a trip at the time and I was really surprised to discover that this man had, according to the papers, had been conniving with the taxpayers to make him a very handsome allowance.

The CHAIRMAN. And he was dismissed, was he?

Mr. BROWN. He was brought over into this conference; that is, the conferee was the only one when this hearing was on, because this was a case where the taxpayer's representative said: "Your terms are evidently satisfactory, but our president is up in the Hotel Washington to-night"——

Senator KING. That is the case about which there was so much publicity?

Senator COUZENS. It was in the papers.

Senator KING. And the man was indicted.

Mr. BROWN. That is the only case I know of, but it shows how things could happen.

The CHAIRMAN. Yes.

Mr. BROWN. And if there is any one section above others where dishonesty could be practiced, it is the amortization section, because chances are so great.

Senator COUZENS. Yet you do not know of a specific case.

Mr. BROWN. I do not; no, sir, because there are a great many cases handled there in the department.

The CHAIRMAN. Does Mr. Brown want to say anything more? If not, we will come back to-morrow morning.

Mr. BROWN. Well, there are many things here that will help the committee and lead up to cases.

Senator COUZENS. You mean that will lead up to some other cases?

Mr. BROWN. Unfortunately, these so-called "Mellon companies"—I had one of their cases—I don't know that—I can't say, don't pretend to say that the Secretary of the Treasury could have connived in any way, shape, or manner in having my report overthrown on one of his pet companies.

The CHAIRMAN. What case was that?

Mr. BROWN. That was the Allen-Davidson Co., of Pittsburgh. It was——

The CHAIRMAN. What kind of a company was it; what did they make?

Mr. BROWN. A steel foundries company; steel; things like that.

The CHAIRMAN. Is there any objection to Mr. Brown going on to-morrow?

Senator COUZENS. Will you be here to-morrow?

Mr. BROWN. At your pleasure, sir. I might suggest, Mr. Chairman, that the representatives of the department be authorized to bring over the records of the Allen-Davidson Co.; that is, my written report along with the written report of Engineer Schwern.

The CHAIRMAN. Is that one of Mr. Mellon's companies that were mentioned the other day?

Mr. HARTSON. The name is not familiar; I do not think it is, Senator.

Mr. NASH. It is not.

Mr. BROWN. It is not a Mellon company?

Mr. NASH. I never heard the name before.

Mr. HARTSON. Mr. Mellon volunteered to send over to the committee the files of any company he was interested in.

Mr. BROWN. One of my assistants who went out with me told me that he had been practically born and brought up in the steel mills and that this was one of Mellon's pet companies.

The CHAIRMAN. And who was your assistant?

Mr. BROWN. C. E. Smith.

The CHAIRMAN. Is he still in the bureau?

Mr. BROWN. He is not; he resigned from the service.

Senator COUZENS. What does he do now?

Mr. BROWN. I believe he is with the American Appraisal Co., if I recall rightly; and, as a matter of fact, a great many of these appraisal companies have been only too anxious to gobble up all the men they could possibly get from the amortization section.

Senator KING. What do these appraisal companies do?

Mr. BROWN. The appraisal companies?

Senator KING. Yes.

Mr. BROWN. They work on claims for amortization.

Senator KING. How long has this business been organized?

Mr. BROWN. They have been under way ever since this amortization law went into effect. You will recall that the witness who just testified said they fought shy of amortization cases owing to the complex nature of them; that they turned these cases mostly over to engineer companies, requesting that they draw up the reports.

The CHAIRMAN. When you were working on this case did you understand it was a Mellon company?

Mr. BROWN. Yes; I did.

The CHAIRMAN. At the time?

Mr. BROWN. Yes.

The CHAIRMAN. From what somebody had told you?

Mr. BROWN. From what my assistant had told me.

The CHAIRMAN. Did he say he had gotten any word from Secretary Mellon about it?

Mr. BROWN. No.

The CHAIRMAN. Did anybody in the department, so far as you know, have any word from Mr. Mellon that sifted down to you about the case, from Mr. Mellon?

Mr. BROWN. Why, it was a case that was in the files.

The CHAIRMAN. I understand.

Mr. BROWN. It was simply one out of a half dozen other cases I was assigned to at the time.

The CHAIRMAN. Now, did anybody at the time approach you, Mr. Brown, to induce you to give a favorable finding to the company because it was a Mellon company?

Mr. BROWN. No; they could not have done it if they did.

The CHAIRMAN. But, I say, did anybody do it?

Mr. BROWN. No, sir; only I rendered my own decision, I say.

The CHAIRMAN. Yes.

Senator KING. Your claim is that the final decision was different from yours?

Mr. BROWN. Absolutely; either Smith and I did not understand the amortization law or else Mr. Schwaren knows all about that law. That was the condition all the way through the amortization section; continual fighting. There was a case there that Mr. Clark remembers, when he first came into the department—which I was given to change by this man Jennings. He said, "Mr. Brown," he said, "I want you to read this office report of Mr. Clark, allowing it upon the grounds that this ship company was building ships for sale and had no Government orders." Well, I did so. When they went before the reviewing engineer, he took this man to task for having disallowed. "Well," he said, "Mr. Carlson said it should not be allowed; they were not entitled to amortization." And so they got into a wrangle about that, and before they got through there were absolutely eight people in that section fighting over it, as to whether that concern should be granted the amortization or not; and the case itself involved only the amount of $36,000—yet they talk about small cases not being intricate! Finally they had to come around to Mr. Clark's opinion in the end.

Senator KING. I think the fact there was a good deal of controversy shows that they were interested to get things right.

Mr. BROWN. They certainly were interested. There was a clique of about five men there and they wanted things to go a certain way.

The majority far overbalanced them, and those fellows were honest, to my way of thinking.

The CHAIRMAN. We will adjourn until to-morrow.

Mr. ROSE. May I state who I am, and ask Mr. Brown to answer some questions with reference to what happened in the bureau?

The CHAIRMAN. Who are you, sir?

Mr. ROSE. C. F. Rose, the man indicted in this case by the bureau.

Mr. BROWN. I have not mentioned any names, sir.

Mr. ROSE. But you mentioned a case, and you said it was brought to your attention. I want to know what was stated about it.

Mr. BROWN. I stated that I saw it in the newspapers.

Mr. ROSE. No; you stated that it was told to you; that it happened in the conference room. Now——

Mr. BROWN. As to what happened in the conference room. I said—no, no; I said——

Mr. ROSE. That has nothing to do with the case at all?

Mr. BROWN. No; that has nothing to do with your case.

Mr. ROSE. Beause the deputy commissioner testified before the House Appropriations Committee about it, and he has already testified in the case, and I have got a copy of that report. I would just like to have the records kept straight; so if you know anything about it I would like to have it, because I am willing that my case should be investigated.

Mr. BROWN. He had been in the conference room alone with this taxpayer; and if there was any reason, any chance, or if there was any disposition on the part of the Government employee, that these things could occur.

Mr. ROSE. Will you state what paper you got that from?

Mr. BROWN. Why, I think it was—it occurs to me I was out in Chicago at the time. I could not say; I think it was a Chicago paper.

Mr. ROSE. This just shows how far the bureau will go, to what extent the bureau will go, to get rid of any employees they want to get rid of.

Mr. BROWN. No question about that; I may have something to show before I get through.

Mr. ROSE. I do not think it is fair on the part of the bureau to make statements here in this committee that are not true.

The CHAIRMAN. He is not in the bureau.

Mr. ROSE. He is telling about a matter that took place in the bureau.

Mr. BROWN. Before I left.

Mr. ROSE. That is what I want to clear up. I want to show they stated falsehoods there.

The CHAIRMAN. The committee will stand adjourned until 2 o'clock to-morrow afternoon.

(Whereupon, at 4.50 o'clock, an adjournment was taken to 2 o'clock p. m., Thursday, March 27, 1924.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

THURSDAY, MARCH 27, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE,
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met, pursuant to adjournment, at 2.05 o'clock p. m.; Senator James E. Watson (chairman) presiding.

Present: Senators Watson (chairman), King, and Couzens. Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. N. T. Hartson, Solicitor Internal Revenue Bureau; Mr. J. G. Bright, deputy commissioner, Income Tax Unit; and Dr. T. S. Adams, tax expert, Yale University.

TESTIMONY OF CHARLES F. BROWN—Continued

Senator COUZENS. How long, Mr. Brown, do you think it will take you to finish up?

Mr. BROWN. I am sure I do not know. This has gone into a totally different line from what I really expected to be called upon to testify to. As Mr. May said yesterday, there was not any department in the whole income-tax division where there were such chances for abuses of the law as there was in the amortization section. They say it has been abolished, but it seems to me it is functioning as a part of the nonmetals division to-day, and will continue to function for some time to come.

Now, I have transcribed part of my thoughts here which I would like to read, if I am privileged and answer any questions that you want to ask.

There was quite a good deal of talk here yesterday in regard to tax experts, former employees. In regard to tax experts who are ex-employees, any attempt to restrict the rights of these men to practice before the bureau can not be of any service to anyone except the large auditing firms who charge very large fees and who would like to remove the competition which tends to keep their fees within smaller bounds.

The ex-employee of the bureau is very much in demand as he knows of certain points in the settlements allowed that are not made public, due to the custom of the bureau in settling disputes by compromise instead of giving specific rulings which would govern future similar cases and make the experts' fees unnecessary.

These compromise settlements are always a departure from the general practice in that the taxpayer whose case is under consideration

is the only one who receives any benefit without some insider advises others, because it is not published. This does not require any specific instance to verify it, as it is self-evident that any case settled privately by a departure from the previous rules and not published to the taxpayers can only be claimed by others who know or who are willing to go to the bat.

The way to remove the expense from the taxpayer is to remove the necessity of his having to hire the expert, by compelling the bureau to be honest in its dealings and to play no favorites. Have the bureau employees instructed to give correct deductions whether claimed or not. The commissioner has acknowledged that the bureau has collected taxes under rulings that were later changed to give exemptions and that the taxpayers who had previously paid were not credited or reimbursed for the excess paid. He has also acknowledged that legal exemptions are not given unless specifically claimed by the taxpayer and it has been shown that the bureau employees were forbidden to inform them of their legal exemptions. Under the laws governing business and commerce this man would be classed as a common thief and be ostracised by honest men. Mr. Mellon denies that any favors were asked for by him for his companies, but no excuses, or exemptions have been offered for the dishonest practices that have been acknowledged by the commissioner.

Can it be that Mr. Mellon condones these practices as an example of shrewd business? And is it not possible that Mr. Mellon knows human nature well enough to know that there are always enough servile individuals who will favor his interests in the knowledge, or hope, that the favors given will keep them solid with the chief? An examination of the records and reports of engineers and auditors who have been discharged on the grounds of inefficiency as compared with records of men retained will show that many of the best men have been dismissed and the true cause of their dismissal is that they have adhered to an honest interpretation of the law. These men have been dismissed without an opportunity of being heard, or defended before an impartial committee, as provided for under the civil service laws; and their reputations blackened unjustly because they protested against what they saw was a dishonest interpretation of the law and because they had shown their superiors that they could not be coerced into granting special favors to anyone.

Now, of course, I can cite these different cases when called upon.

Senator COUZENS. What different cases?

Mr. BROWN. Well, I will cite that Allen S. Davidson case, for instance—has anyone got the copy of my report and the correspondence in connection with it? That is a consolidated case, if I recall.

Senator COUZENS. What do you mean by "consolidated case"?

Mr. BROWN. It means a company that has a number of different concerns under consolidation, for instance, like the United States Steel Corporation, which embraces a great many companies like the great Tennessee Coal & Iron Co., and cases like that—consolidated returns.

Mr. HARTSON. May I interrupt the witness? Reference was made yesterday to the Allen P. Davidson case and the statement was made in his testimony yesterday that he understood from a coworker that the Secretary of the Treasury, Mr. Mellon, was interested in that company.

Mr. Mellon is not interested in that company and has never been interested in that company. So that the witness's inference in regard to the Secretary's interest in that case is overdrawn. He did not participate in it; does not own any of the stock in it, and never has.

Mr. BROWN. I simply drew my inference from information given from one bureau employee to another, which they are supposed to know about before they go on the cases and otherwise they are supposed to inquire well into the different phases of the case; and as this engineer told me, he said:

Mr. Brown, this is one of Mellon's pet companies; it looks very fishy to me.

Nothing further concerned me, just simply what was the company rightfully entitled to. I found out that in the examination there was a certain portion of their claim that they were not entitled to and I disallowed it; here is the thing: How did that information get to that company so quickly after that return of ours was written up before the A–2 letter was sent out? Because information was gotten into the department right away and another engineer was sent to investigate that case and that engineer immediately was sent right up, post haste, to Pittsburgh, where he met the officials of this company, and he was taken by automobile a two days' trip down to the mines down in Virginia, and came back and allowed them everything they claimed, and we two engineers had disallowed it. How did they get that information so quickly?

The incompetence of many retained employees is indicated by one of the engineers who spent over six weeks on the case of the Quaker Oats Co., and when his report was turned in his superior, Mr. De La Mater, the chief of the section, found it necessary to have the entire field work done over and reported upon by another engineer. That is a matter of record. It is well known that a Mr. Carlson was assigned to that case, and all the expenses and everything attached to that investigation went for naught; yet that man is still right in the service.

As I have already stated, this is the type of men that the bureau has retained to adjust cases which often amount to millions of dollars; and an investigation will show that the pliable men were the ones that have been given the cases of the favored taxpayers.

The morale of the section is well illustrated by a conversation overheard between two of the old men, the principal statement of which was: "That damn fool, Brown, is killing the job; he handled 21 cases in the field in three weeks." Now, you see, I suppose in the general procedure, I ought to have taken probably about two months; and if I had been some of the men instead of going to work and using private conveyances, for instance using the interurban lines and the jitney buses, if I had simply consulted the time-table and hung around in the hotel and waited for comfortable transportation, I might have been through in about a month or a month and a half.

I trust that this senatorial investigation will also devote some time to righting the wrongs done to many engineers and men of long and successful experience who have relied on the honesty of their superiors and the civil service laws and have moved their families here, many of them; some have purchased homes, and some are veterans of the last war.

Mr. Blair's attention has been called to the foregoing facts, and in addition to the use of the Government funds to give joy rides to

favored employees, copies made of taxpayers' reference cards on amortization cases have been secured, and these are worth many thousands of dollars to outside parties. This information also was given to Mr. Blair, but the man that did that, or was guilty of this, is still retained in the service; and you can imagine—here is a full index of all the amortization cases in the section and a man that had not any right to go to the file case had copied quite a number of those cases when he was apprehended—why, nobody realizes what that would mean.

The CHAIRMAN. Who was he, Mr. Brown?

Mr. BROWN. If you wish me to turn over a copy of this data that I gave to the special intelligence bureau of the Treasury Department I will do so.

The CHAIRMAN. What was it he did?

Mr. BROWN. We had in the department a case, possibly about 2 feet square, and in that were all the reference cards to the amortization cases then in the department. That index card file was under the custody of one or two people in the section and no other employee of the department had a right to go there; but it was never locked; we had our file cases never locked; the rules did not permit the locking of any files.

The CHAIRMAN. What was it this man did?

Mr. BROWN. He went to work and made a copy of these cases; and if you only realize what this might mean to such a man if he was getting out of the service or what it might mean to outside auditing firms to know cases that were before the department—think of the vast amount of money they could save by having that information.

The CHAIRMAN. I am trying to find out what it was he did; what was it he did?

Mr. BROWN. He made a copy of these reference files.

The CHAIRMAN. Then what? Just merely making a copy of that kind would not amount to anything; what did he do with it after he made the copy?

Mr. BROWN. We do not know; but he had no right to do so.

The CHAIRMAN. Did anybody else make a copy?

Mr. BROWN. No; they were not privileged to—not that I know of.

The CHAIRMAN. This man was not privileged to, was he?

Mr. BROWN. Absolutely not; he was an appraisal engineer just the same as I was.

The CHAIRMAN. Do you know, Mr. Brown, that he made the copy?

Mr. BROWN. I do, because——

The CHAIRMAN. Did you see it?

Mr. BROWN. Because his desk was right next to mine.

The CHAIRMAN. Yes; and——

Mr. BROWN. And when one of the parties that had charge of the matter came to this file case for these reference cards and could not find them he made the remark, he says: "Where the hell are all these reference cards?"—and I saw he was quite excited about it—I said: "I don't know, some of them might be in this drawer here, in this desk next to mine."

He opened them and there they were; and this man had just returned from the wash room, and he said to this man, he said:

"What the hell are you doing with these cards in your desk?"

"Oh," he says, "I was making just a copy of a few cases on which I would like to go out on," he said, "for all the others are picking favored cases to go out on."

The CHAIRMAN. Do you know what he did with his copy?

Mr. BROWN. I do not know whatever became of it. Now, then, there was a great hurrah made recently on account of these dismissed employees going in to the tax cases, tax work, while we had not heard any criticism prior thereto. For instance, here is a man by the name of Wayne Johnson, former Solicitor of Internal Revenue, now in New York as an attorney for the American Petroleum Institute, and various oil companies; and we have Carl Mapes, a former Solicitor of Internal Revenue, succeeding Wayne Johnson, his brother-in-law, now with various oil companies, probably associated with him in New York.

We have E. H. Batson, former Deputy Commissioner of Internal Revenue, now representing various oil companies before the Treasury Department.

There was a man—I don't know his initials—by the name of Powell, formerly chief of the natural resources division now representing various oil companies.

Mr. Manning, formerly director of the Bureau of Mines, now with the Petroleum Institute of New York.

W. N. Davis, present member of the tax simplification board, Treasury Department, millionaire Oklahoma oil man, formerly associated with Jake L. Hamon, friend of Sinclair, now president of the Mid-Continent Oil & Gas. He is on the inside of the Treasury and Revenue Bureau matters.

The CHAIRMAN. Who is this man?

Mr. BROWN. W. N. Davis.

The CHAIRMAN. And you say he is in the Treasury Department?

Mr. BROWN. He is in the Treasury Department; he is at present member of the tax simplification board.

In the criticism of the department by the National Industrial Conference Board, I note on page 2 it states:

> Cases of arbitrary and unreasonable assessments are by no means rare, a situation often due to immature judgment or lack of adequate knowledge on the part of the Government official or agent.

Now, I would like to cite the case of the National Aniline Dye Co. They put in a claim for amortization and the case was disallowed by the reviewing engineer. They felt that they were entitled to their claim, but what was the result? They employed an attorney; of course, it cost them a good round sum of money to do it; and he got up a very elaborate brief and——

Senator COUZENS. There was not anything wrong with that, was there?

Mr. BROWN. Was there anything wrong with that?

Senator COUZENS. Yes.

Mr. BROWN. This National Aniline case?

Senator COUZENS. Was there anything wrong in their hiring an attorney to get up a brief?

Mr. BROWN. Not a bit, but it shows the expense they are put to by the lack of knowledge on the part of some Government agents in handling these big cases.

When that brief came in, this engineer, after reading it, said, "Well, I guess we will have to allow them their claim."

Doctor ADAMS. May I ask you a question?

Mr. BROWN. Yes, sir.

Doctor ADAMS. Is it your opinion, as a rule, that reviewing engineers, or field engineers, decide doubtful points against the taxpayer? Do you think they should, and do they, as a rule?

Mr. BROWN. Yes, and no. I have in mind the case of a man where I felt there was quite a question. I took it before Mr. Flournoy, whom I consider to be one of the most fair and reasonable chief engineers we had in the department, and I stated this case to him, and I said, "I think, Mr. Flournoy, that this ought to be decided in favor of the Government." He said "No; oh, hell, no; allow it to the taxpayer. We are not here to do the taxpayer." That shows you what some of the engineers want to do, how they want to treat the taxpayer; but it is when it gets into the hands of men that do not understand the work that the harm is done.

I cited the case of where Government funds had been unlawfully used in joy rides, yet there was nothing done about it. The section was abandoned, or abolished, and, as I understand, the chief, De La Mater, was requested to resign so as to stop any investigation.

I would like to cite a case here of how the taxpayer feels about these things. I was assigned out on some cases up in New Jersey. One of them was a large concern; and when I passed in my card I told the attendant that I would like to see some official of the company. That is what the appraisal engineers had to do; they were the men who had to go out and represent the Government; the auditors never had any occasion, as a rule, to get in touch with the heads in institutions; we were the people that had to do it. So after a while this young lady said, "If you will go down to the end of the corridor, the last office on the left, our president will see you."

I went in there, and there was a gentleman I should judge about 60 years of age, white hair, and plump, quite impressive. This is the greeting I got: "So you fellows have finally got ready to take up our amortization claim. Why all this delay?"

And I had to go to work and give the best reason I could, on account of delays. I told him the section was functioning at least 50 per cent under what it should be and that the taxpayers all over the country through the press were clamoring for taxes to be cut down and administration affairs in Washington cut down. He had nothing further to say or complain of on that source. So he said, "Well, what basis are you working on?"

"Well," I said, "we are taking up this case using 1916 prices, as of June 30, as a base, and running our percentages from that, being worked so as to arrive at a fair post-war cost. No; I see here that you go back to the price in 1914, and that the department does not consider."

He said, "Is that what you are doing?" And he jumps up and he said, "I might as well hold up my hands and let you fellows go right through my pockets." He said, "I guess I will have to see my Senator and see what you fellows are going to do down there."

That is the way people feel on the outside. I was talking awhile ago with one of the members of the Republican National Committee

and he told me he had an awful lot of trouble with the amortization claims.

"Look," he said, "I have a complaint right here in my pocket now, from a large taxpayer out in Indiana, who said the case was investigated and the report was written up, the amortization report was written up way last January, and he said, "Here we haven't had it audited yet." He said, "Why is that; what is the reason? I want to find out. I am complaining," he said, "because we can not balance our books; we don't know where we stand."

So I said, "Well, I will tell you what the reason is, that is not a favored company; if it was there would be a little pink slip up in the corner marked 'Expedite.'"

"Well," he said, "I will soon find out about this thing." He said, "I had occasion to go down there a little time ago on another case, and I said to De La Mater, I said, why can't this case be audited?"

"'Well, we haven't got men enough, haven't got auditors enough to do it,' he said."

"Well, why the hell don't you get them?"

Senator COUZENS. You might just as well leave that language out.

Mr. BROWN. I am using his exact phrase, just what he used, sir.

Senator COUZENS. You might just as well leave it out.

Mr. BROWN. All right. They spoke about the activities of the men that had gotten out from the department, but I will say one thing, and that is, I was talking with the vice president, one day, of the Baldwin Locomotive Works, and he told me, he said:

"Mr. Brown, our firm has been pestered to death by professional auditors to write up our claims, but I would not have anything to do with them. We just bided our time, and one day there was a very likely chap sent down here to go over our books from the department. We saw that he understood his business and we grabbed him."

That is where the men go. That man, I understand, was being paid $100 a day for every day he put in at the Baldwin Locomotive Co.'s plant.

That shows you why the department's employees are in such great demand.

The CHAIRMAN. Is that all, Mr. Brown?

Mr. BROWN. That is all, sir, unless there may be something here—of course, if there is anything that you want to know from an outside standpoint in reference to the amortization section, I think I can give it to you as well as anybody.

Senator COUZENS. Who designated the cases on which a pink slip would be attached?

Mr. BROWN. Why, they came from up above.

Senator COUZENS. You do not know who designated them?

Mr. BROWN. No, no; somebody that had the power up above us, over us.

Senator COUZENS. Were no cases expedited except those that had the pink slip attached?

Mr. BROWN. No, no.

TESTIMONY OF MR. A. C. ERNST, OF ERNST & ERNST, CLEVELAND, OHIO

(The witness was duly sworn by the chairman.)

Senator COUZENS. I understand you are here, Mr. Ernst, in the interest of Mr. Mellon, or the Gulf Oil Corporation, to explain to the committee as far as possible the reasons for the refund of some three million six or eight hundred thousand dollars—I forgot the exact figures. I think, Mr. Chairman, that he might just as well proceed in his own way.

The CHAIRMAN. I think so. What is your business?

Mr. ERNST. Managing partner of Ernst & Ernst, certified public accountants.

The CHAIRMAN. How long have you been engaged in that business?

Mr. ERNST. Over 20 years.

The CHAIRMAN. In Cleveland?

Mr. ERNST. In Cleveland.

The CHAIRMAN. What is the other member of the firm?

Mr. ERNST. There are 9 other partners; 10 in all.

The CHAIRMAN. Under the firm name and style of Ernst & Ernst?

Mr. ERNST. Under the firm name and style of Ernst & Ernst.

The CHAIRMAN. Who is the other Ernst?

Mr. ERNST. There is no other Ernst; there was a brother, who retired some 17 years ago.

The CHAIRMAN. You just keep the firm name?

Mr. ERNST. Yes.

The CHAIRMAN. Are you incorporated?

Mr. ERNST. We are a partnership, and always have been.

The CHAIRMAN. Always have been a partnership?

Mr. ERNST. Yes; no corporation.

The CHAIRMAN. When were you employed by the Gulf Oil Co.?

Mr. ERNST. Senator, if it meets your pleasure I have written out here a chronological order of events that probably will give the whole story. In September, 1919, I was consulted by some banking interests regarding a plan for a merger which they had in mind, which included the Gulf Oil Corporation. I should like to add there that some publicity was given later regarding the merger which involved the Gulf. This was not the matter that I was retained in.

I went to Pittsburgh and met Mr. George S. Davison, vice president, also Mr. W. L. Mellon, president of the Gulf Oil Corporation.

The CHAIRMAN. What relation is he to Andrew W.?

Mr. ERNST. He was a nephew, I understand. This is W. L. He was then, and I believe now is the president of the Gulf Oil Corporation, the parent, controlling company. There are 13 subsidiaries, in addition, 14 in all.

The CHAIRMAN. The Gulf Oil is an independent company?

Mr. ERNST. Yes; the entire discussion related to a plan of audit with the particular purpose in mind of ascertaining the real asset values, net profits, dividends, good will, etc. The importance of determining the March 1, 1913 asset values was discussed at some length. There was only incidental mention made of the Federal tax return. In other words this was a matter of a merger, the earning power, etc. It had nothing to do with the Federal tax returns.

Returning to New York I submitted a written opinion to the bankers under date of October 3, 1919, outlining the plan of procedure. On October 13, 1919, my firm was authorized to proceed with the work under the program which I had recommended. We immediately started a staff of our experts to verify book figures and under the program we were to trace back the accounts to the organization of the company in 1907.

The items of good will, and March 1, 1913 values were the immediate considerations which we then had in mind.

In December, 1919, Mr. Davison, vice president of the Gulf Oil Corporation authorized my firm to prepare the 1919 Federal income and profits tax return, and to review all prior returns, amending such as were necessary, of the Gulf Oil Corporation and subsidiary companies.

The 1917 and 1918 returns which covered the high tax years—60 per cent in 1917 and 80 per cent in 1918—had not been examined by the Government; and Gulf Oil Corporation had prepared these returns through their own people without outside assistance. It had become apparent to me that Gulf Oil Corporation and subsidiaries had not employed a uniform and accurate basis in their bookkeeping covering such important items as depreciation, depletion, obsolescence, etc., nor had any reflection of the March 1, 1913 values been recognized on the books of the corporation. As a matter of fact, Mr. Davison had very definitely explained to me the policy pursued in past years whereby a more or less arbitrary charge off had been made at the end of each year to cover all of these factors

In any report which we prepared looking forward to the basis of a merger these elements were of great importance; and during the year 1919 the regulations of the Treasury Department had been greatly clarified; in fact, to such an extent that definite rulings had been laid down which it was necessary for taxpayers to follow. Quite naturally, then, in my several discussions with Mr. Davison, he felt that considerable time could be gained by employing my firm to not only prepare the 1919 return, which he understood would be prepared under a somewhat different basis than the returns of prior years as prepared by them, but also to revise the returns of prior years so that these prior year returns would be on a uniform basis with the return for the year 1919.

Senator COUZENS. Just at this point—do you mind being interrupted, or would you prefer to finish your general statement first?

Mr. ERNST. Just as you please, Senator.

Senator COUZENS. How far back did you go to revise their returns, back to 1913?

Mr. ERNST. No, Senator; we went back to 1909, the date of the first tax law affecting corporations.

Senator COUZENS. And did you send in revised returns during those periods?

Mr. ERNST. We did, sir.

Senator COUZENS. Had each year been settled independently as you had gone along, or were they still open?

Mr. ERNST. Many of the prior year returns—that is, take, for instance, 1909; in this case we went to 1907, the inception of the company to build up its records on the important feature of invested capital, etc.—the date of the start of the corporation; but there was

no tax on corporations until the year 1909, so that the returns were amended from 1909 to date.

Senator COUZENS. And are these amended returns in the records that you propose to present to-day?

Mr. ERNST. Yes, sir.

Senator COUZENS. You may proceed.

Mr. ERNST. They are all here. Naturally it was quite apparent to me that in view of the later regulations the returns of prior years must, of necessity, be revised before an accurate basis could be had for the return of the year 1919 because of the changes in taxable income, invested capital, etc.

On January 22, 1920, I wrote a letter to Hon. Daniel C. Roper, Commissioner of Internal Revenue, advising him that I was doing certain work on the Gulf Oil Corporation tax return, and confirmed in that letter a conference I had had with Mr. Roper on December 18, 1919, in which I had discussed with him in some detail the requirements of the Government in connection with the ascertainment of the March 1, 1918, values. In other words, I did not care to take the responsibility of having my client incur a large expenditure in the preparation of schedules which, after completion, would not be in a form satisfactory to the Treasury Department. The letter to Mr. Roper is as follows:

WASHINGTON, *January 22, 1920.*

In re Gulf Oil Corporation and subsidiary companies.

Hon. DANIEL C. ROPER,
Commissioner Internal Revenue, Washington, D. C.

MY DEAR SIR: In our conference this afternoon with you, you suggested that we see Mr. Callan. I am pleased to report that Mr. Peacock and myself did this and believe he understands the situation fully.

The Chairman. Who is he?

Mr. ERNST. Mr. Callan was Mr. Roper's chief assistant.

Following your further suggestion that a written memorandum be submitted in regard to this matter in order to protect the company against any penalties which might result from the discovery of additional taxes by agents of your office, we confirm the conference with you on December 18, 1919, when Mr. Peacock and myself brought to your attention the fact that we had been retained by this corporation in connection with a review of various tax features, and that our work was now under way; also the fact that in due course of time after we completed our work it is our purpose to file any amended returns which may prove necessary.

In seeing you this afternoon the writer simply wished to convey the information that we were making progress and we hope you have no immediate plans whereby field examiners will take up the investigation of these returns while our work is still uncompleted. We do hope, however, that when our services are completed a field examination can be made by your examiners so that the whole matter can be disposed of promptly.

The writer wishes again to express his appreciation of the time and courtesies extended by both yourself and Mr. Callan to-day. With best personal wishes, I remain,

Faithfully yours,

A. C. ERNST, *Managing partner.*

In this connection I may say further that the explanation of my previous conference on December 18, 1919, with Mr. Roper came about through the fact that much publicity had been given to a large financial transaction whereby a prominent manufactuer had acquired the holdings of certain minority stockholders in his company and I had understood that Commissioner Roper had delegated a special

staff of experts from his department to consider various phases of this tax problem, particularly having in mind the questions of good will, March 1, 1913, value, which was tax free, and other matters.

I told Mr. Roper very frankly that I would very much apperciate the same cooperation and explained to him at some length the situation which was confronting me which, in many respects, was similar to this other case.

He did not give me any assurance of his cooperation and finally asked me to see his chief assistant, Mr. Callan, which I did. Mr. Callan stated that this other matter had required a good deal of the time of a number of the chief men in the department and that they were extremely busy and suggested that I proceed with the work we were doing and take the matter up with him at a later date.

Mr. Callan did advise me that the department had done absolutely no work on the returns of the Gulf Oil Corporation, and that they had no immediate plans to check up their returns in any way; and he expressed satisfaction that we were reviewing the accounts of the company along the basis which I outlined to him.

At no time during this entire period did I make any estimates of tax savings to Mr. Davison, or to any other official of the Gulf Oil Corporation or its subsidiaries. As a matter of fact, it was not possible for anyone to know what the final tax for any year would be until all of our computations had been completed.

All of our amended returns from the year 1909, when the first income tax law affecting corporations went into effect, up to and including the year 1919, including all supporting schedules had been filed with the department early in the year 1921; as I recall it, in January or early February. In other words, from early August or September, 1920, until the fore part of 1921 we were constantly completing schedules and submitting them to the department in Washington for examination.

Along in October, 1920, the field examiners from the department in Washington took up the actual examination of the various schedules in the returns, and as I recall it there were five on this work at one time at the offices of the company in Pittsburgh. The field examiners did not complete their work until the middle of February, 1921, and there was approximately four months spent by the Government examiners in actually checking the books of the company in conducting the field examination. In addition to these field examiners there was a considerable force of engineers of the natural resources division who had been giving their attention to the various schedules relating to property values, location, depletion items, geologists' reports, etc. In addition to this the various representatives in Washington attached to the audit review section of the consolidated returns division had also been reviewing schedules and following the work with the field examiners. As a matter of fact, after we had completed all of our amended returns the year 1917, that is the first high tax year, showed an additional tax liability of the Gulf Oil Corporation and subsidiary companies in the amount of $87,002.44 over and above the tax which the company had already paid.

A different situation pertained to the year 1918, however, because the companies' officials had been working on this return which was due to be filed in the year 1919, and on account of a new law having been passed for the year 1918 the officials of the company decided

to calculate the tax on substantially the same basis as the year before without having properly considered the new provision in this law pertaining to depletion allowance and discovery values. This was a new feature in the 1918 law and no oil company was in a position to anticipate the final result.

It should further be remembered that the law affecting the year 1918 was not finally passed by the Congress until February, 1919, and the regulations were not promulgated until April 17, 1919; and immediately many questions were raised regarding the interpretation of these regulations as affecting oil companies because of the new problems which were confronting everyone.

The final adjustment of the taxes for the year 1918 showed an overpayment made by Gulf Oil Corporation and its subsidiaries in the amount of $1,430,931.79. This result for the year 1918 had not been ascertained by us, however, before the return for the year 1919 was due, and the officials of the Gulf Oil Corporation, fully realizing that we were making substantial changes in all of the prior year figures, but not being in a position to know the effect thereof, determined upon the policy of filing merely a tentative return for the year 1919 and paying thereon a substantial round amount of taxes.

The final result for the year 1919 showed that the arbitrary payments previously made purely as estimates were excessive to the extent of $2,431,586.16.

These three years, therefore, 1917, 1918, and 1919, showed net excessive payments by Gulf Oil Corporation and subsidiaries of $3,775,515.51.

The CHAIRMAN. What year was that, Mr. Ernst? I did not get that?

Senator COUZENS. That was the total.

Mr. ERNST. 1917, 1918, and 1919.

The CHAIRMAN. Did you then make the statement that that was the total tax paid?

Mr. ERNST. I beg pardon?

The CHAIRMAN. Was that the total tax paid by that firm?

Mr. ERNST. May I read that again?

The CHAIRMAN. Yes; I was interrupted when Senator King came in; I would like you to state that again.

Mr. ERNST. These three years, therefore, 1917, 1918, and 1919 showed net excessive payments by Gulf Oil Corporation and its subsidiaries of $3,775,515.51.

Senator KING. That is assuming that the computations were made different from what you contended?

Senator COUZENS. No. I think not.

Mr. ERNST. No, Senator, this was the final result ascertained after complete review by the Treasury Department. This was the final report of the Treasury Department, the final communication.

The CHAIRMAN. For the years 1917, 1918, and 1919?

Mr. ERNST. Yes.

Senator KING. There had been a change in the assessment somewhere, a rectification somewhere, as you contended.

Senator COUZENS. He said that they had changed their whole method of reporting for a period of years and this was the result.

Mr. ERNST. This was the net result; that is correct. In addition to this the years prior to 1917—that is to say, the years 1909, 1910,

1911, 1912, 1913, and 1914—showed additional taxes due to the Government from certain of the companies in the group; and these taxes were assessed and paid notwithstanding the fact that all of them had been outlawed under the statute of limitations, and notwithstanding further that certain other companies in the same group had overpaid their taxes for the same period; that is to say for the years commencing 1909 to 1914, inclusive, and there were refunds due to these companies from the Government, but owing to the expiration of the statute of limitations the Gulf Oil Corporation was not in a position to recover these overpayments and has not done so.

The CHAIRMAN. What is the amount of them?

Mr. ERNST. Something like $50,000. That is to say when the final official Government letter came to us the Government took off what was owing to it from 1909 to 1914 which had been outlawed.

The CHAIRMAN. What was the amount of that?

Mr. ERNST. Something like $60,000—less than $100,000—they deducted that but there was no law by which they could pay us what we had overpaid.

The CHAIRMAN. The statute of limitations ran against you but not against the Government?

Mr. ERNST. Well, it was a case where they were paying us back money and they deducted everything that was owing to them.

The years 1915 and 1916 showed additional taxes due from some of the companies and overpayments as to others with net refunds for the years 1915 and 1916 of less than $100,000 for all companies.

Claims for refund were filed in behalf of each company in the form prescribed by the regulations prior to the date that Hon. A. W. Mellon, Secretary of the Treasury, took office; and these claims for refund were based upon the final audit and review previously made by the Government officials, and were for the exact amount shown in the Government's official communication known as "A–2" letter dated February 28, 1921, and signed G. V. Newton, the then Deputy Commissioner of Internal Revenue.

Senator COUZENS. When were the refunds actually paid; do you know?

Mr. ERNST. My recollecton, Senator, is that the actual payment was made along the middle of April, 1921.

Senator COUZENS. In one lump sum or in different amounts?

Mr. ERNST. No, as to each subsidiary company.

Senator COUZENS. The last one was paid in the month following Mr. Mellon's taking office; is that correct?

Mr. ERNST. I believe it was the middle of April, 1921.

The CHAIRMAN. What was happening from the time the allowance was made until the same was actually paid? A period elapsed there of a year and a half—no, not quite that much.

Mr. ERNST. No, you see the official letter, Mr. Chairman, came February 28, that is when the Government had completed all of its review.

The CHAIRMAN. That is February 28.

Mr. ERNST. 1921.

The CHAIRMAN. 1921. I was mistaken, then, as to the date. Have you been the accountant having the taxes of this Gulf Oil Co. in charge since that time?

Mr. ERNST. In an advisory way only.

The CHAIRMAN. 1923?

Mr. ERNST. Yes. The plan of procedure; that is, the system and the basis of these reports has been followed by the company in their later returns. We have not officially made later returns.

The CHAIRMAN. You have not?

Mr. ERNST. No; the basis established in the final communication from the Government, February 28, 1921, has been adopted by the company.

The CHAIRMAN. That fixed the basis so that the figuring of the tax was simply a matter of computation after that on the agreed basis.

Mr. ERNST. That is correct.

The CHAIRMAN. During your consideration of this question did you at any time have any conference with Mr. Mellon, either before or after he became Secretary of the Treasury?

Mr. ERNST. Yes; I had just one conference, in September, 1919, and that was when this merger basis had been under discussion.

The CHAIRMAN. Was that conference about taxes?

Mr. ERNST. It mentioned one feature of taxes which I took up with Mr. A. W. Mellon, and that was the absolute necessity of our establishing the March 1, 1913, value. This was in September, 1919. I have never talked with Mr. Mellon during the entire program of this work, during the time it was going on, or after it was completed; never saw him.

The CHAIRMAN. Have you been the accountant for any other company in which Mr. Mellon was interested?

Mr. ERNST. Yes, I have.

The CHAIRMAN. What other companies, Mr. Ernst?

Mr. ERNST. Well, the Standard Steel Car Co. is another one.

The CHAIRMAN. Yes.

Mr. ERNST. We have as accountants for many years examined some of Mr. Mellon's banking institutions.

The CHAIRMAN. Yes.

Mr. ERNST. In Pittsburgh.

The CHAIRMAN. Have you at any time been directly employed by him or had conferences with him in regard to those institutions?

Mr. ERNST. Never.

The CHAIRMAN. Never have at any time?

Mr. ERNST. No, sir.

The CHAIRMAN. Who represented him in making dealings with you, or contracts with you for your services?

Mr. ERNST. Well, as I related here really the initial interview I had I was there alone and that was with Mr. W. L. Mellon, who was the President of the Gulf Oil Corporation, Mr. Davison, the Vice President of that company, and later in the day after the program had been tentatively agreed to by them on the merger basis, I discussed with A. W. Mellon, this March 1, 1913 matter. That is Mr. A. W. Mellon raised the question of the necessity of our going into matters so thoroughly, and he asked the usual questions as to why we were doing it, and why it was necessary.

Senator COUZENS. Can you tell us, Mr. Ernst, just what elements entered into the change in these computations, just what factors made the returns show overpayments?

Mr. ERNST. I think unless you wanted to get into a highly technical discussion, Senator, I could probably outline the broad considerations.

This return involves about 37 volumes of typewritten matter. It is a very large and detailed return, as you could appreciate with all of these companies going back many years.

Under the 1917 act, that is the law for that year and the 1918 law as to fixing invested capital was exceedingly important. I take it you men know that the question of the invested capital, was to an extent, the hub of the wheel of taxation for those years with the high tax rate. The review of that feature was naturally important, but probably more important in this case. We had many concerns, citing one concern in New England where it was the pride of that old company that they had entirely written off their entire plant account and equipment.

"Why," they said, "We haven't it on our books for anything, just wrote it off."

Well, I should say, reviewing my own experience, which has been from the days I left school—I went into an accountant's office—so that I have seen many cases of auditing financial matters for 25 years. In the old days there was no policy, no rule for depreciation. The old method was that if a company had a good prosperous year with substantial profits the board of directors would probably write off a considerable round amount. If the next year the earnings were not so good they would write off less; and in many cases make no charge off at all. Of course there was no uniformity going back for a period of years so that the element——

Senator KING. You are speaking of general industrial corporations?

Mr. ERNST. General industrial corporations. Now, Senator, I will come to the Gulf Co., just giving you that thought. In the first place shares of the Gulf Oil Co. were not listed on the New York Stock Exchange—a few shares were sold in Pittsburgh. These men had kept their books for years on a basis which was conservative to them and no doubt satisfactory. That was no different than a hundred corporations that I could tell you about. They had one account where at the end of the year they would write off a certain amount which meant depreciation, depletion, obsolescence, and these other features.

Of course, when I came into the situation I immediately said:

> Well, that must all be changed. For instance, here is the March 1, 1913, value. The law permits you to establish that value, and as you are using up that value it is tax free because you are using up and disposing of asset values you had on March 1, 1913, which the law gives you without a penny of taxation.

In determining the position of the company that feature alone made a considerable change in all of the figures.

Senator COUZENS. Right there, if you will pardon the interruption, when the company made these returns to the Government in 1917 and 1918 before you got into the case did they use the figures that they had set up in an arbitrary way?

Mr. ERNST. They had not set them up in any way as to March 1, 1913; they had used these arbitrary write-offs simply as a deduction.

Senator KING. You mean for depletion and obsolescence, Senator?

Mr. ERNST. Yes, sir; all combined.

Senator COUZENS. After you got into the case then you found that these set-ups had been too large; is that it?

Mr. ERNST. No, we found this: We found as to the year 1917 that the company actually owed $87,000 more taxes than they had paid.

Senator COUZENS. But the reverse was the situation in 1918?

Mr. ERNST. In 1918 the reverse was true, Senator, because we had a new law which dealt on an entirely different basis with oil companies.

Senator COUZENS. Just explain that.

Mr. ERNST. In 1918 there was a provision in the law which created what we call discovery values. Are you men generally familiar with that?

Senator COUZENS. Yes.

Senator KING. I do not see how it could apply to discoveries which had been made years before and on which you had got your credit.

Mr. ERNST. But, Senator, it did. You understand the larger oil companies generally have four classes of property. There will be an acreage that they are drilling actively, producing property; when they have that producing area they have immediately another class of property which they buy up surrounding it for protective purposes. That is the second class. They have a third class, which is wildcat property; that is, exploration work, new fields. They have a fourth class where they have determined that there are dry holes.

Supposing, under the 1918 law, that any oil company owned a large amount of property and had for many years, but had not developed it; some one comes along and wildcats in the area and finds a new well; that is immediately met with these so-called offsetting wells. That is, unless the other companies go in and put their own wells in that territory the wildcatter is likely to get the oil. When we come to the offsetting well there is clearly a discovery value in the new field which the 1918 law dealt with on a different basis than it had ever been dealt with in 1917 or prior years.

Senator COUZENS. Just tell us how it is dealt with in the 1918 law.

Mr. ERNST. In 1918 let us assume a premise where we had some property acquired years before; no wells in the vicinity, in the area prescribed in the regulations, and a new man came in and drilled a well. We immediately went in and offset it and had large production. We are entitled under the 1918 regulations to put a discovery value on that well; and the prices of oil were pretty high in 1918. Now, we put that discovery value on all of the data and we are entitled to a credit in our tax return on the basis of that discovery value.

Senator COUZENS. How much?

Mr. ERNST. For the market value.

Senator COUZENS. You mean for the market value of all oil extracted?

Mr. ERNST. Of the oil extracted.

Senator KING. Or for the alleged market value of the property.

Mr. ERNST. No; supposing that we had in the income of the year 1918 a certain amount of oil. We would first follow the regulations which are very clearly set down in 1919 pertaining to those of valuing that well. Now, that means the location and the area of it and the map, and the drilling, and all that. We have to determine, therefore,

the basis of credit that we are allowed to take on that well against the oil that we take out and sell. It is the amount of credit that we are allowed against our income.

Senator COUZENS. Can you explain to me how it is possible to give a larger credit for depletion than the earnings of the company show? That has come up in a number of our hearings.

Mr. ERNST. I think this would be more clear, if it would be of any advantage to you gentlemen, to refer to the Government regulations on this subject. They are quite exhaustive and quite clear and were made in 1919.

Senator COUZENS. If you can answer that question by referring to them, all right; try to answer it the best way you can.

Mr. ERNST. I will refer here to Treasury Decision 2956, made in December, 1919.

Senator COUZENS. Did that decision apply to the returns of the year 1918?

Mr. ERNST. That laid down the basis under which these factors for prior years in 1917 had to be determined as to maps, geologists' reports, and other data for the natural resources division. Probably I can explain your question; I think I can clarify it. You wanted to know the basis whereby an oil company can get a greater credit than its income; was that it?

Senator COUZENS. That is it.

Mr. ERNST. Supposing that in the year 1918 with the market price of oil high that we had found the new discovery of a well, that is, it was a new well in a new territory. We had the output in barrels; naturally we sold it, and will assume at the market price. As against that income which we received we were entitled to take credit, and there were several——

Senator KING. For the discovery value you mean?

Mr. ERNST. For the discovery value. We were entitled to take from that regular depreciation on the equipment, on the drilling rigs, etc. That was one credit. We were entitled to take credit for depletion, taking that oil out of the property. Now, if that discovery was made and valued within 30 days of the discovery on the basis of a certain market value there, it might follow that in a year later, 1919, if the market value of oil went down, that the credit we were receiving might be larger; that is, the credit that had been established under this ruling, because you make the basis of the credit on the facts as they then were.

The CHAIRMAN. I think you are all right on your law, but I do not agree with the law. A man comes in and pokes down a well; he discovers oil; you drill an offset well right by it and then you become the discoverer too, you discover it over again, and you are entitled to credit on that offset there for the amount of oil taken out—discovery value, but you did not discover it at all.

Mr. ERNST. But may I say——

The CHAIRMAN. You did not discover it. I am not quarreling with your interpretation of the law; I am quarreling with the law itself.

Mr. ERNST. Of course I can say this in the absence of probably reading a rather long Treasury Department ruling on the subject, that the element of the discovery value is very clearly defined as to

what you could do. Now, in fairness to any oil proposition—supposing that an acreage we owned had not been drilled and a man went in and developed a new well, what basis of credit would you allow him?

Senator KING. You ought to allow him——

The CHAIRMAN. That is not the point; you have this well drilled and you drill an offset well; then you get a discovery value to the full amount of the oil taken out although you do not discover any.

Mr. ERNST. That is limited by a certain area, an acreage of a hundred and sixty acres.

The CHAIRMAN. A hundred and sixty acres; that is my recollection. Nevertheless that is big enough to take up your offset territory.

Mr. ERNST. As a rule——

Senator KING. Assume that you had property there which might have cost you about a thousand dollars an acre and was carried on your books at a thousand dollars an acre; somebody comes along, as Senator Watson just indicated, drills a well in contiguous territory, gets oil, and you drill an offset well and bring in oil of such volume as to give it a value in the market say of $2,000,000, and you are getting enormous production from that which you are selling for cash; instead of paying any dividends upon that you begin to figure and to say, "While it is true we only paid $160,000 for the 160 acres, now that we have got a well there on it it is worth $2,000,000; we are depleting it because it is running 10,000 or 20,000 barrels a day." You figure first the value of your land; you say that land now is worth $2,000,000 although it only cost you $160,000, and you deduct that; then you deduct depletion and the first thing you know you have the Government indebted to you. Is not that the way you operate it?

The CHAIRMAN. You left out obsolescence and depreciation on the drilling rig.

Senator KING. Yes; obsolescence, depreciation, overhead; is not that the way you operate it?

Mr. ERNST. Answering your question——

Senator KING. Waiving technicalities that is the net result, is it not?

Mr. ERNST. There would be a large credit.

The CHAIRMAN. Yes; I think the law gives them the right to do that.

Senator KING. I deny that it does, Senator.

Mr. ERNST. And the 1918 law——

The CHAIRMAN. I do not think there is any doubt about that.

Mr. ERNST. And the 1918 law provided this feature that was new, the discovery value.

Now, we could take the maps here of any well that might interest you and show you exactly the geography of it and the drilling record, and the whole thing, and the area, and date of discovery, so that the record is very complete on each well.

Senator KING. The fact is that property which you regarded two, three, or four months before you struck oil, was of small value, two or three hundred thousand dollars, becomes in the market excessively valuable and produces income of twenty, thirty, or forty thousand dollars a day, instead of there being a tax upon that of any considerable amount, or tax at all, by the method adopted of allowing depletion and ascertaining value, and deductions, and so on, you avoid, or rather you do not pay any tax of any considerable amount not-

withstanding you made a profit of two or three million dollars upon the enterprise.

Mr. ERNST. There is no doubt, Senator, that you are entitled under the regulations to a credit. All of these oil companies own acreage which they had not proven, they had not drilled. Some of that acreage may had been purchased very cheap and carried for years. Here is another well goes up, opens up a new oil field. There is no doubt that that element coming in there vastly enhanced that property.

Senator KING. Yet if a man had a piece of real estate worth $10,000 in 1913, and, because of a boom coming along, he sells it in 1920 for $100,000, he would have to pay a tax on $90,000, the difference between the two amounts, would he not?

Mr. ERNST. He would be entitled to the March 1, 1913, value.

Senator KING. I am assuming it cost $10,000. Your well was intrinsically worth no more on the 1st of March than his house with relation to values in 1918, but because of some adventitious circumstances you are forced to drill an offset well; then you secure all that enormous value and claim these credits?

Mr. ERNST. Well, I think that we should consider that discovering oil wells in new territory involves many losses as well as profitable vantures.

The CHAIRMAN. Did you take into consideration the loss and gains of the whole enterprise in determining what you did with that whole well? That is to say, the Gulf Oil Co., with all of its subsidiaries, may have great investment, may have great losses, may have a great deal of dry territory, but they bring in this one well, and you take all the property into consideration, of course, when you go to determine the tax of that corporation, do you not?

Mr. ERNST. Yes, Senator.

Senator COUZENS. Not what you take on that one well.

Mr. ERNST. But you must deal with each well.

The CHAIRMAN. You have to deal with each well.

Mr. ERNST. Each well; under the Treasury regulations you must submit the same detail for each well.

Doctor ADAMS. What is the custom, Mr. Ersnt, or what was the habit with respect to the losses sustained in dry wells? Would those losses be charged off against income from other properties, or would they be charged against the capital value derived from discovery value?

Mr. ERNST. In the Gulf case—I can not answer your question broadly as to any other large oil company—but in the Gulf case the cost of the dry wells was charged off.

Doctor ADAMS. Charged off against current income?

Mr. ERNST. Yes; as a loss.

Doctor ADAMS. I think that is the general practice under the law and I call the committee's attention to it because I think it is improper and an unjust feature. Discovery values are set up primarily to recoup the producer for each discovery, and he would not get the losses; they are not charged against the capital values obtained from discovery but are charged against current income. I think you have done just exactly what every other oil producer has done, but I regard it as a very unfair feature of the law.

Mr. ERNST. I have never checked up against many oil companies. Of course I have offices in Houston, Fort Worth, Dallas, San Antonio, and New Orleans, and I have seen much wild catting in oil. Texas had quite a period when oil was the headliner and many people went into it. They found many shallow pools. But here was a situation, for instance, under the 1917 law with the war on and the demand for oil very great. Supposing that an individual under the 1917 law went in and wild catted and was fortunate enough to get a large well and he was offered a million dollars on the ground for it. The tax on that proposition was so great that the hazard the venture plus the tax practically nullified any profit to be gained from exploiting the oil field.

The CHAIRMAN. Have you been the accountant for other oil companies?

Mr. ERNST. Only in a minor way, Mr. Chairman; not any of these so-called large oil companies. We have had many of these investigations in Texas of these minor companies where, unfortunately, stockholders lost a great deal of their money.

The CHAIRMAN. You applied this same law then at other times?

Mr. ERNST. These are the standard regulations I should like to say here, if it would add anything to the thought which seems to be in your mind, that the matter of this discovery value and the drilling records, and area, and sands, and location of the territory is very largely a matter of geologist work and dealt with in the natural resources division of the department as a separate thing, and my experience has been that thay have gone into it very minutely acting under the Treasury regulations.

Senator KING. Is it not your experience that those oil-producing companies, by the construction placed upon the law, have escaped paying any amount of tax for the oil production, no matter how great the production was?

Mr. ERNST. I think, Senator, the word "escaped"——

Senator KING. Well, they did not pay, then?

Mr. ERNST. They simply had a certain basis of credit which was applied against their income.

Senator KING. Yes, I assumed that, that under the interpretation placed upon the law the result was that these producing oil companies notwithstanding the large production during the past five or six years, with the credits which they have been allowed for discovery value and for depletion, and for wear and tear, and for exhaustion, and for obsolescence, and expenses has resulted in their not paying any taxes on the product from those wells.

Mr. ERNST. I would not say they have not paid any because they have; Gulf oil has paid taxes.

The CHAIRMAN. What proportion of the net income of the Gulf Oil Company was paid in taxes for the years 1917, 1918, and 1919?

Mr. ERNST. I really could not say; I have not the figures here.

Senator COUZENS. Could you take those figures out of the records we have here?

Mr. ERNST. If all the records are here—they are voluminous—I could get those figures.

Senator COUZENS. Could you say offhand whether after these amended returns were made and the refunds granted it left any taxes paid by the Gulf Oil Co. in those years?

Mr. ERNST. Oh, yes; it left taxes that the company paid.

Senator COUZENS. I hold in my hand here the amended return for the period from January 1, 1918, to December 31, 1918.

Senator KING. 1919?

Senator COUZENS. No; to December 31, 1918. An agreement under section 1312 was entered into. I understood the other day from the solicitor, Mr. Hartson, or some other member of the staff of the bureau, that there had been no requests on the part of the bureau to settle under section 1312. Is that right, Mr. Hartson?

Mr. HARTSON. That is correct.

Senator COUZENS. Have you a copy of the agreement that was entered into under this section in this case?

Mr. HARTSON. Senator, I do not know that we have a copy here. They are in printed form, and follow the language of the statute. I can easily get you one, if there is not one in the files here.

Senator COUZENS. Will you see if there is one in the file here, because it says here that:

> This return has been closed by agreement under section 1312 of the revenue act of 1921. Under no circumstances other than those outlined in that section must any additional assessment or reduction of tax liability be made.

The agreement was dated August 11, 1923. I would like to see if we have that agreement.

Mr. HARTSON. Yes; I think we have a copy of that.

Senator, you asked Mr. Ernst, but he was not able to furnish you the answer, what the amount of the tax was left due for the year 1918, for instance, after this refund had been granted, and I am reading now from the A–2 letter, one of the schedules of that letter, which has been testified to here by Mr. Ernst as having been dated February 28, 1921, and which formed the basis for the final adjustment for those years.

The corrected tax for the year 1918 for the Gulf Oil Corporation and its subsidiaries was $1,902,532.33. That is the amount that was left due and remained unrefunded. It was the true tax liability of the company for that year, as finally determined.

Senator COUZENS. And was it actually paid?

Mr. HARTSON. And was actually paid.

Senator COUZENS. Mr. Hartson, will you give us those other figures?

Mr. HARTSON. Those figures that Senator Couzens asks for covering the tax paid for the three years, 1917, 1918, and 1919, of the Gulf Oil Corpoartion, after the refunds had been granted, are as follows:

The tax paid for 1917 was $3,549,016.48. The net income for that year was $18,395,219.92.

For the year 1918 the tax paid was $1,902,532.33. The net income for that year was $11,698,267.28.

For the year 1919 the tax paid was $368,413.84. The net income for that year was $4,613,015.38.

Senator COUZENS. Mr. Ernst, can you tell us why, in 1917, the tax paid was between 18 and 20 per cent of the net revenue, in 1918 it was about 15 per cent, and in 1919 it was about 8 per cent? Can you explain the drop from about 20 per cent to about 8 per cent which took place in the proportion of the net earnings paid to the Government?

Mr. ERNST. Well, as I see the computations, Senator Couzens, the year 1917 was slightly less than 20 per cent.

Senator COUZENS. Yes.

Mr. ERNST. Do we check there?

Senator COUZENS. Yes.

Mr. ERNST. The year 1918 was about 18 per cent, and the year 1919 was about——

Senator COUZENS. About 8 per cent.

Mr. ERNST. Yes; a little over 8 per cent.

Senator COUZENS. Yes.

Mr. ERNST. Well, I take it that 1917 and 1918 are fairly close together; that is, about 20 per cent and 18 per cent. In 1919, the profits, you see, had dropped from $11,700,000 in 1918 to only $4,600,000, so that there was a heavy fall in the net profit.

Senator COUZENS. The percentage would change in proportion to the fall, would it?

Mr. ERNST. Yes, sir.

Doctor ADAMS. These figures cover both income and profit, do they not?

Mr. ERNST. Oh, yes; that is the total tax.

Senator COUZENS. I asked the solicitor for a copy of the agreement that was made with the Gulf Oil Corporation under section 1312 of the revenue act of 1921. The said agreements were dated August 11, 1923. I show you the agreements, and ask you if you drew those agreements, or knew anything about them?

Mr. ERNST. I had nothing to do with them, Senator.

Senator COUZENS. You had nothing to do with that?

Mr. ERNST. My work terminated when the official communication known as the A–2 letter, came in on February 28, 1921.

Senator COUZENS. Mr. Hartson, could you tell us why, if the final adjustment was made on February 28, 1921, about four days prior to Mr. Mellon taking office, it took from that date to August 11, 1923, to obtain a final settlement under section 1312?

Mr. HARTSON. I think it did not take that long to obtain the agreement, Senator Couzens. Having no personal knowledge of it, I can only tell you my view of it, but I think it was probably asked for during that interim. They only asked for the agreement a short time before it was finally entered into.

Senator COUZENS. What was the purpose of asking for an agreement as late as August, 1923?

Mr. HARTSON. I can not answer that, Senator. The purpose of entering into a 1312 agreement is well stated by the section itself. It permits a taxpayer to, except for certain contingencies—roughly speaking, those of fraud—have his tax finally determined through some later readjustment by some official of the Government. It introduces into a tax liability an element of certainty, which is highly desirable and which can only be obtained, ordinarily speaking, by the running of the statute of limitations.

Senator COUZENS. Then, the Government, under section 1312, does not ask for any settlement?

Mr. HARTSON. As a matter of policy, I think the Government has not invited agreements under section 1312. The reason for that, I think, is that the Government does not go back over these cases and attempt to introduce any new elements into them. In other words,

the Government officials have before them these cases which are yet unsettled, rather than those that have been once determined, and those cases that have been determined and are closed are not again referred to by the Government officials unless the taxpayer comes in with some sort of request or claim.

Senator COUZENS. Have you any files brought down here showing requests for settlement under section 1312?

Mr. HARTSON. I have not been personally through the file.

Mr. GREENIDGE. Yes; there is such here.

Mr. HARTSON. Is there a request filed there?

Mr. GREENIDGE. Yes.

Senator COUZENS. Please let me see it.

Mr. HARTSON. I might say it is not at all unusual for taxpayers to put in requests for settlement of their tax liability, under section 1312, sometimes a year or more after their case has been finally closed in the bureau. Some taxpayers are not advised of section 1312. They do not know of it until some time has gone by.

Senator COUZENS. While looking up this request for a settlement under section 1312, can you give me the amended returns for the year 1919?

Mr. HARTSON. Oh, yes; they are all here, Senator. I think in the files that the Senator has there is the copy of the meeting of the board of directors of the Gulf Oil Corporation, authorizing the entering into the agreement under section 1312.

Senator COUZENS. Yes; I saw that here.

Mr. HARTSON. I do not know whether the letter would be in there or not.

The Senator has asked for the letter in which request was made that returns for the year 1917 and 1918, inclusive, be settled on the 1312 agreement. It appears from our records that no letter of transmittal was ever received by the company, but this resolution the Senator has saked about, authorizing it, was brought here by some official of the company and left with the bureau officials. There was no letter transmitting it. The Senator has asked for the 1919 returns, and this is the tentative return that Mr. Ernst has spoken of, and is the return itself which was later filed.

Senator COUZENS. In dealing with these questions, Mr. Ernst, did you have an attorney?

Mr. ERNST. We had no attorney, outside of the company's attorney.

Senator COUZENS. Who was the company's attorney?

Mr. ERNST. Judge Batts was the legal counsel of the Gulf Oil Co.

Senator COUZENS. During none of this time, did you have any other attorney than this one whom you have just named?

Mr. ERNST. I had no conference with any other attorney; no, sir.

Senator COUZENS. Did you have any discussion with regard to depletion allowances being made to the lessee versus the lessor, or both, or do you know anything about that?

Mr. ERNST. Well, I knew that problem came up, because there were properties owned in fee, as well as under leasehold, and the legal matters in connection with that were handled by the company's legal department.

Senator COUZENS. As I understand it, the first ruling was that there was no depletion credit allowed to the lessee.

Mr. ERNST. Yes; I think that is correct.

Senator COUZENS. Was not that ruling afterwards changed, so that a depletion allowance was allowed to the lessee?

Mr. ERNST. I believe it was; yes, sir.

Senator COUZENS. Do you know when that took place?

Mr. ERNST. I do not. It was entirely a legal matter, and the basis of dealing with the company's property was established by their legal department. Our feature was purely the accounting end.

Senator COUZENS. Doctor Adams, do you know anything about how that was done within the bureau? You were connected with the bureau for some time, as I understand.

Doctor ADAMS. My impression is that the lessees were first granted the depletion allowance in the 1918 law; that up to 1918, that was refused; namely, up until the 1918 law, the lessee could not claim depletion. That was the regulation until modified a couple of years ago, I think in 1922.

Mr. ERNST. I think there was a distinct reversal, Doctor Adams, was there not, on that previous ruling?

Mr. LINZEL. That was Treasury decision 3386.

Senator COUZENS. Can you read that Treasury decision into the record?

Doctor ADAMS. The substance of that, Senator, was that the lessee might be given depletion in the oil industry. Up until that time, the lessee had been denied depletion, both for solid minerals and oil.

Mr. GREENIDGE. Here it is.

Senator COUZENS. When this ruling was made, did both the lessor and the lessee receive depletion credits?

Mr. HARTSON. I can not tell you about that.

Mr. Ernst, do you know whether the Gulf Oil Corporation owned a considerable amount of land under lease?

Mr. ERNST. Yes; they had quite a few leases.

Doctor ADAMS. Did they obtain depletion on that prior to 1918?

Mr. ERNST. I believe they did; yes. I believe it was under this later ruling.

Doctor ADAMS. What time was your case settled?

Mr. ERNST. In February, 1921.

Doctor ADAMS. Did the regulations open to the public at that time permit the deduction for depletion of oil and gas wells to lessees?

Mr. ERNST. I know that the subject was under discussion with the legal department of the Gulf Co., and that they had taken the position, as I remember it, that they were entitled to it. In other words, many of these early oil regulations were not as clear as they later became, and our instructions from the Gulf Co.'s legal division were to treat fee property and lease property on the same basis.

Doctor ADAMS. That position has recently been confirmed by a decision of the circuit court of appeals, has it not; or do you know?

Mr. ERNST. I do not know. I believe that various legal phases of this case were before the solicitor's department at that time.

Doctor ADAMS. Did you discuss lessee depletion in the course of the settlement?

Mr. ERNST. No; not in the course of settlement. I had nothing to do with it.

Doctor ADAMS. You do not know whether that fact was brought to the attention of the department or not?

Mr. ERNST. Yes; I know it was.

Doctor ADAMS. The department allowed the lessee depletion?

Mr. ERNST. Yes; because our schedules clearly showed the date of the lease, if we had leased property, and if it was fee property.

Doctor ADAMS. The printed regulations which were given to the public, however, were to the effect that the lessees could not claim depletion; is not that correct?

Mr. ERNST. There was something going on in the solicitor's department on those Treasury decisions at the time. I am well aware of that. There was considerable controversy. We had a case which went to the Supreme Court, quite a famous mining case, the Biwahick mining decision. We were interested in it, where that issue was involved, and I know there was a good deal of question as to just the basis; but in this case the return and the basis of it were brought to the attention of the Government.

Senator COUZENS. I would like to ask the engineer who handed me the Treasury decision to come around here.

Mr. Greenidge, when did you enter the department?

Mr. GREENIDGE. October 4, 1920.

Senator COUZENS. Do you remember this decision, which was approved by Secretary Mellon on August 22, 1922, dealing with the depletion on oil and gas properties?

Mr. GREENIDGE. Yes, sir; if it is Treasury decision 3386, which I presume it is.

Senator COUZENS. According to this book, that was approved by the Secretary of the Treasury.

Mr. GREENIDGE. On August 22, 1922.

Senator COUZENS. Was that the first time that you were familiar with the allowance for depletion to lessees?

Mr. GREENIDGE. No, sir; I could not say that it was.

Senator COUZENS. When did you first become familiar with the fact that the Treasury Department, or the Internal Revenue Bureau, allowed depletion to lessees as well as to lessors?

Mr. GREENIDGE. Not until this date was it allowed, generally speaking, unless a man—it was not allowed.

Senator COUZENS. You say generally speaking.

Mr. GREENIDGE. Yes.

Senator COUZENS. Well, just what do you mean?

Mr. GREENIDGE. I should not have interjected "generally speaking." Not prior to that date was it allowed.

Senator COUZENS. Do you know of any case where it was allowed prior to that date?

Mr. GREENIDGE. No, sir; there might have been cases that I did not know of, but I personally have no knowledge of any cases. I might amplify that a little, if I may. The discussion of that allowance had been going on before I entered the department, and because of the language of section 214 (a) of the revenue act of 1918 the last sentence of which reads as follows:

> In the case of lessees, deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee—

It became quite evident that this point would sooner or later be raised, and it could not be acted upon by the department the consensus of opinion being that there would be no means of denying

such deduction to the lessee in view of the clearness of the statute on that subject.

Senator COUZENS. The statute provides that an equitable allowance be made between the lessor and lessee. How is that equitable allowance arrived at?

Mr. GREENIDGE. Well, ordinarily the lessor owns one-twelfth of the production of the property. The one-twelfth is not fixed, however. In some instances it is one-sixth, in some instances one-eighth, and in some instances it runs up as high as 40 per cent, the lessee owning the remaining amount, and if an equitable apportionment is to be made within the limits of the statute, of course, the lessee would be entitled thereby to an allowance.

Senator COUZENS. Mr. Ernst testified, as I recall—and if I am not correct, Mr. Ernst will correct me—that depletion was allowed the lessee in the Gulf Oil Co. case for the years 1917, 1918 and 1919.

Mr. HARTSON. Now, Senator, I think I should interrupt there to call the Senator's attention to the A-2 letter, bearing date of February 28, 1921, which is the letter Mr. Ernst testified to, and call the Senator's attention to the last paragraph in it, which reads as follows:

> The amount of the over-assessment above mentioned is subject to an amendment upon the final determination as to the deductibility of loss, exhaustion or amortization of useful value based on the March 1, 1913 values of the leaseholds allowed in the above computation for the years 1916 and 1917.

In other words, the question apparently at that time was still in the air, although the letter had settled it on the basis of the allowance, subject to later alteration, if the question was raised.

Senator COUZENS. What have you to say in connection with the years 1918 and 1919, Mr. Hartson? This letter that you have just referred to does not refer to the years 1918 and 1919.

Mr. HARTSON. And the law itself, which Mr. Greenidge has already made reference to, specifically allows it for those years. In those earlier years, there was no reference in the law to depletion on leaseholds.

Senator COUZENS. Will you tell me why this decision of the Treasury Department of August 22, 1922, was made, if it was clearly understood that the settlement was made with the Gulf Oil Corporation?

Mr. HARTSON. The decision merely publishes to the public generally that that is the decision.

Senator COUZENS. In other words, the Gulf Oil Co. knew what the decision was in 1921, when they made their settlements, and it was allowed in 1916, 1917, 1918, and 1919, although the public did not know it until August, 1922?

Mr. HARTSON. I think, Senator, the Treasury decision which has been referred to should be read. It covers the years 1916 and 1917, which the law did not cover.

Senator COUZENS. Yes; but it was not approved until August 22, 1922, and I would like to inquire how the public is going to know about these decisions if they are published years after the allowance has been made to certain corporations.

Mr. HARTSON. I do not know any way, Senator, for the public to know until there is some form of publication. After the publication is made, however, those who have become informed by reason of the publication may reopen cases and take advantage of the ruling and

the Treasury decision. Why that was delayed, I do not know. I was not here then, and I can not explain that; but the mere fact that it was finally published, everybody having notice of it then and being able to take advantage of it, I can not see that anybody has been prejudiced.

Doctor ADAMS. Can a Treasury regulation, Mr. Solicitor, be revoked by letters signed by a deputy commissioner?

Mr. HARTSON. It can not.

Doctor ADAMS. What was the existing Treasury regulation at the time this letter was written?

Mr. HARTSON. At the time the letter was written?

Doctor ADAMS. Yes.

Mr. HARTSON. The existing Treasury decision?

Doctor ADAMS. Yes.

Mr. HARTSON. At the time the letter was written, the Government made no allowance for depletion of leasehold.

Doctor ADAMS. Formally speaking, that was the law; until this other Treasury decision was issued, that was the formal interpretation of the law, was it not?

Mr. HARTSON. This was a formal interpretation of the law up until this Treasury decision was issued.

Senator COUZENS. In making up your schedules, Mr. Ernst, in these amended returns, can you tell us what additional allowance was received by the Gulf Oil Corporation for depletion allowed to the lessee?

Mr. ERNST. I could not say offhand, Senator, no. That would be a matter of computation, and I should have to go through the entire depletion and segregate it.

Senator COUZENS. Is there any member of your staff here, Mr. Hartson, who can tell us from these records that you have brought down the amount of allowance received because of depletion allowed to the lessee?

Mr. HARTSON. I think it can be shown, yes, Senator.

Senator COUZENS. I wish you would have some of your staff look it up, please.

Mr. HARTSON. I would like to have the Senator restate his question, so that we can understand thoroughly what is wanted.

Senator COUZENS. My question was that, after it was determined to allow the Gulf Oil Corporation, as lessee, a depletion credit for the years 1916, 1917, 1918, and 1919, how much, in dollars and cents, did that mean to the Gulf Oil Corporation.

Mr. GREENIDGE. Senator, I will have to answer that question by saying that while we have a number of figures before us on the general subject, we have them as totals. We would have to segregate them to show what was allowable to fee ownership and to lessor ownership.

Senator COUZENS. Well, Mr. Ernst testified that he made up all of these scheudles, and you checked the schedules. Certainly, the schedules must sh . / what was allowed by the lessee depletion.

Mr. GREENIDGE. Yes, sir; the schedules do show it.

Senator COUZENS. Where are they?

Mr. GREENIDGE. They are here, but we have not computed it to show that particular item which you have requested.

Senator COUZENS. Well, in making up the schedules, how could you arrive at a schedule without having in the schedule such an important item as an allowance for depletion to the lessee?

Mr. GREENIDGE. We have that, sir.

Senator COUZENS. Well, where is it?

Mr. GREENIDGE. I have it before me, but it is in grand totals, and it does not show what proportion of actual production came from lessee property. They were owners in fee, lessors, joint operating owners, and lessees.

Senator COUZENS. Yes; but when you came to arrive at these claims made by the corporation, you had to have a set of figures.

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. To prove these totals.

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Where are the set of figures that proved these totals?

Mr. GREENIDGE. They are in the files here.

Senator COUZENS. Well, that is what I want.

Mr. GREENIDGE. Well, we would have to take the entire files——

Senator COUZENS. Well, that is what I want. I want the files. I want to show just what the allowance is on lessee depletion.

Mr. HARTSON. Senator, if you have no objection to our having the necessary time to segregate those figures, we can segregate them by to-morrow.

Senator COUZENS. Well, they are all here, are they not?

Mr. HARTSON. The engineers tell me that it could not be done by to-morrow.

I would like to ask Mr. Ernst whether, in the schedules that he has brought with him and has in his own files, he has such a segregation.

Mr. ERNST. I think, Mr. Hartson, that we may get a little better picture of this in considering that there are about 37 very large typewritten volumes covering these schedules, and that each company has its own schedules, and there is a mixed ownership in each company. Now, all of the data that Senator Couzens is inquiring about is there. I would not care to give any figures until I reviewed that and checked it off, because the plan of operation might be clarified, when I say that, first of all, these depletion schedules for various companies and in different territories were built up; they were constantly sent into your natural resources department, because of the location, the territory, and the conditions. As they checked them off and reviewed them, parcel by parcel, we depleted them, and naturally altogether for one company; that is, to bring the returns of one company together, so that in this return that the Senator has referred to is simply the total which is given; it is what the return calls for.

Now, all of these individual returns, by each of these companies, of course, are segregated. This is the consolidated return of all of the figures grouped together. The Government has received the entire detailed information on each company, and has reviewed it.

Senator COUZENS. I understand that, and that is all I am asking for—the figures that they checked when they O. K'd your claim for depletion. That is perfectly simple.

Mr. ERNST. Yes.

Senator COUZENS. I should not think there would be much difficulty in getting that.

Mr. ERNST. I say, Senator, the figures are here, but there is an amount of labor involved in resegregating them, as you have put the question. We have segregated them, as the Government return was printed, as required.

Senator COUZENS. But to substantiate these figures, the schedules have been submitted.

Mr. ERNST. Exactly so.

Senator COUZENS. Now, these schedules are here.

Mr. ERNST. They are.

Senator COUZENS. So as not to unnecessarily delay these proceedings, I will ask the auditors and engineers if they can pick out just one case of one corporation from the many subsidiaries that are a part of the Gulf Oil Corporation, and show how much was allowed for depletion to the lessee.

Mr. LINZEL. From this volume that you are working on, I think we can get it for 1917.

Senator COUZENS. While the engineers are looking that up, I will ask Mr. Greenidge if he knows of any other case, not connected with the Gulf Oil Corporation, where the depletion was allowed the lessee prior to the rulings promulgated in August, 1922?

Mr. GREENIDGE. I could not say that I personally do, Senator, although there is a possibility that there were. To my knowledge, I can say that a great many taxpayers delayed making an effort to settle their returns until after a decision was rendered on this important point, because of the time and expense they would have been put to in revamping, so to speak, their systems, and at that time, in the department, we were fearful that we would be called upon to do a vast amount of work because of the settlements which taxpayers had requested, wherein their depletion had not been claimed as lessees; but we found that a comparatively small number had so settled their cases, the larger number having apparently preferred to let the matter remain open until a final decision had been rendered.

Do I make myself clear, Senator?

Senator COUZENS. I think so. Prior to this allowance to the lessee for depletion, did the bureau allow full credit for depletion to the lessor?

Mr. GREENIDGE. Oh, yes, sir.

Senator COUZENS. But in this case the depletion allowance was divided between the lessor and lessee?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Have you figures here to indicate what division was for depletion allowance between the lessor and lessee?

Mr. GREENIDGE. In this particular case?

Senator COUZENS. Yes.

Mr. GREENIDGE. Yes, sir; we have the figures here, but not in such concrete form as we could hand them to you at this moment and give you the information you request.

Senator COUZENS. Mr. Ernst, in arriving at the valuations for depletion purposes, was a percentage of return allowed so as to get at the valuation?

Mr. ERNST. Yes; I believe it was.

Senator COUZENS. What percentage of return was figured in basing the valuation of these companies?

Mr. ERNST. I would have to look that up. That was something over three years ago. The basis had been worked out with the Government department, where they were handling all of these cases.

Doctor ADAMS. You are referring there to the rate of interest used to get the present worth?

Mr. ERNST. I presume the Senator does; yes.

Senator COUZENS. Yes; that is it.

Doctor ADAMS. That is the percentage you have in mind?

Mr. ERNST. Yes.

Senator COUZENS. Well, from all of your work on these accounts, which you did for the purpose of ascertaining Federal taxes, for the purpose of amalgamation, and for the purpose of combination, you must have used some figure, and you must be able to recall some basis of percentage return that you used.

Mr. ERNST. I do, Senator. Of course, I simply said what I did, because I am in personal touch with a vast number of cases, and I have not particularly referred to any of those points in this case, and that is, to refresh my memory. I have a rather vague impression that it was 5 per cent. The department can verify the facts. I would like to put that in with the qualification.

Senator COUZENS. That is all right. Now, I would like to ask if you think 5 per cent on a hazardous business like this is, and I understand it is called hazardous; at least the Government so treats it by these munificent allowances, is a rather low figure?

Mr. ERNST. I think, Senator, on the face, it might look low. On the other hand, I am dealing with many of these problems purely from the banking side; that is, the security of income from an investment standpoint. Now, on the basis of the value of the property of the Gulf Oil Corporation, which I believe was exceedingly low and conservative, if that is true, and it is my opinion that it is true, then 5 per cent on a low and conservative valuation would really be equitable. However, if the valuation had been very large, I should say 5 per cent might not be so low.

Senator COUZENS. Yes; but if you will figure back, for instance, when you say that you will use 5 per cent return as a basis, a corporation earning $50,000 would be valued at $1,000,000?

Mr. ERNST. Yes.

Senator COUZENS. And a corporation earning $50,000 on a 10 per cent basis would be valued at $500,000?

Mr. ERNST. That is very true.

Senator COUZENS. Then, I will ask you if, in figuring the valuations of these properties, in using a 5 per cent return basis, you were giving them double the valuation that you would have if you had allowed them a 10 per cent return?

Mr. ERNST. Only this, Senator——

Mr. ERNST. The initial premise of the value itself. The Gulf Oil Corporation had been an extremely conservative corporation. Its property values had been very low. I have in mind the records of many of these wells, where they had been valued on a certain basis of value, and the oil actually taken out and sold and extinguished the entire capital value on the books, indicating that it was extremely conservative——

Senator COUZENS. I know, but——

Mr. ERNST. Therefore, 5 per cent on such a conservative capital value must be considered in relation to the capital value.

Senator COUZENS. I do not get you at all. It seems to me—I do not charge that you do it intentionally, but you evade the question.

When I start out to buy a newspaper, for instance, and I ask the value of the newspaper, the owner will say, "I will sell you this newspaper on an earning capacity of 5 per cent;" and if, as I said before, that newspaper is earning $50,000 a year, he will charge me $1,000,000 for his newspaper. If he says, "I will sell it to you on a 10 per cent basis," I look up the earnings, and if it is earning $50,000 per year, he will only charge me $500,000 for the newspaper. Therefore, no matter how conservative he may have been in his own bookkeeping, it made no difference in fixing the value of that property; and, therefore, your statement that the conservatism of the Gulf Oil Corporation was a factor in determining the value of the property has no weight whatever.

Mr. ERNST. Well, except, Senator—and your statement as to my trying to evade the question is one that I would like to differ from you on, because I am not trying to evade anything here.

Senator COUZENS. I did not say you did it intentionally, but I asked you a specific question.

Mr. ERNST. Yes.

Senator COUZENS. If, in fixing the value of the Gulf Oil Co. properties on a 5 per cent return basis, you were not fixing it on a very low return?

Mr. ERNST. Yes; but, Senator——

Senator COUZENS. Why put in a "but"? Just say yes.

Mr. ERNST. Well, I might simplify the proceeding if I could say yes, but I assume you want the benefit of my frank judgment.

Senator COUZENS. Yes; but I thought "yes" was the benefit of your frank judgment.

Mr. ERNST. It is not, because when you come to compare a newspaper with an oil company, we can well determine the pool and the quantity of oil in a given area, where it is a proven field. It is a matter of the company's geologists and the Government geologists, together with expert opinions of other people. Now, if we value that oil in the ground as a million barrels, but it is only based on 600,000 barrels or 750,000 barrels, or 500,000 barrels for conservatism, then 5 per cent on that conservative value is not out of order.

Senator COUZENS. I still evidently do not make myself clear, because what the Gulf Oil Corporation estimated as the content of a well had no bearing whatever. If the well contained 1,000,000 barrels of oil, and the Gulf Oil Corporation said 750,000 barrels, it had no weight with the Government in fixing valuation, did it?

Mr. ERNST. Well, I think it was an element for consideration.

Senator COUZENS. Well, I do not see why, because, under that theory, any corporation, then, can value or estimate its contents of wells at a low estimate, so as to receive a lower or a higher valuation, as the case may best be for the corporation. Now, I understand you to say that, as your recollection serves you, the 5 per cent basis was used?

Mr. ERNST. Yes; I have qualified that.

Senator COUZENS. Yes. Well, I understand from the information I have that that basis was used, but, as I say, I may not have anything that is any more accurate than what you have.

Mr. ERNST. I assume that you meant the department would know the facts.

Senator COUZENS. Does the engineer know?

Mr. GREENIDGE. We will look that up for you, Senator. Offhand, I would not like to attempt to state it exactly.

Senator COUZENS. Well, these records here show, do they not?

Mr. GREENIDGE. Yes. We will look that up.

Doctor ADAMS. Mr. Ernst, for Senator Kings' benefit, won't you tell him how this rate of return enters in?

Senator KING. Yes; I have been compelled to be in attendance on two committees to-day.

Doctor ADAMS. In general, it first becomes a measurement of the oil in the ground, or an estimate, and then you estimate what that will, in future years, yield; then, to get the value, you have to discount that back to the present, and it was in discounting back to the present in that manner that you used the 5 per cent; is that the fact?

Mr. ERNST. Yes.

Senator KING. That is what I thought.

Doctor ADAMS. And larger values come with lower interest rates, in general.

Senator COUZENS. Now, I want to point out this, that the man who received a valuation based on a 5 per cent return was twice as well off, so far as valuation was concerned, as the man who received 10 per cent as a basis; is not that so?

Mr. ERNST. Oh, surely. Yes, I agree with that.

Senator COUZENS. Do you know of a case where 10 per cent was used?

Mr. ERNST. I do not. There were not many decisions published. Offhand, I know of none bearing on that subject. The department files would show, of course. It was a matter that was both carefully checked by the department itself, and their conclusion was final. It was done in 1920 and 1921.

Senator COUZENS. Mr. Greenidge, can you tell us the basis of return that was used in computing the values of these oil properties generally?

Mr. GREENIDGE. The ultimate reserves as estimated and approved by the department; that is to say, the estimate of the ultimate amount of oil that would be produced from the various fields in question. That is the basis.

Doctor ADAMS. Mr. Greenidge, what is the usual rate of return, or, as I think of it, the interest rate, that is employed in making these valuations in this field?

Mr. GREENIDGE. Well, it is a different rate for practically every field and different rates for different operators in the same field, depending, of course, upon the peculiar circumstances in each case.

Senator COUZENS. Now, in that connection, please give us a typical case where you allowed a 5 per cent return and a typical case where you allowed a 10 per cent return.

Mr. GREENIDGE. Suppose a taxpayer claimed a 500,000-barrel ultimate reserve in his field and claimed 5 per cent as his discount rate, and another man in the same field claimed 1,000,000 barrels ultimate production. The department, if it accepted the first estimate of reserves and discount value, would not accept the same

discount factor for the 1,000,000-barrel reserve, the conditions being approximately equal, because the basis of value being the ultimate reserve would be twice in the lesser case what it was in the former case, and naturally the hazard or improbability of the 1,000,000 barrels ultimate production would be much greater than the improbability of the 500,000-barrel ultimate production, and, for that reason, a higher discount factor would have to be applied.

Senator COUZENS. In other words, you say that because a man has 1,000,000 barrels of oil——

Mr. GREENIDGE. Because he estimates that.

Senator COUZENS. Well, because he estimates the 1,000,000 barrels of oil, he might be charged a 10 per cent discount rate, and because a man estimates 500,000 barrels he might be allowed a discount rate of 5 per cent. On just what theory do you arrive at such a conclusion?

Mr. GREENIDGE. Well, the probability of the larger estimate approaching more nearly inaccuracy than the smaller estimate.

Senator COUZENS. What is the use of all of this work on the part of the geologists to determine the contents of wells, if you are going to use the basis that you have described of inaccuracy, of overestimate or underestimate? What is the use of all of this work of the geologists, if you are going to use a theoretical conclusion, such as you have just indicated?

Mr. GREENIDGE. Of course, we all know that honest differences of opinion exist among geologists, as they exist among other classes of people. Some have very conservative ideas; some have very inflated ideas of value. The fact is that value is a thing which is not easily determinable on commonplace articles, much less oil fields, which are, as you know, under the ground and invisible.

Senator COUZENS. Then, it would pay an oil company to underestimate the contents of the wells, thereby getting a lower discount rate and raise the value and be credited with a further depletion charge, rather than to estimate the fair and equitable contents of the wells, and thereby be compelled to accept a higher discount rate, and therefore a lower valuation of his property and a lesser depletion charge?

Mr. GREENIDGE. I would not say yes or no to that, Senator. I would want to resolve that into figures, to be sure. I am inclined to think that the ultimate reserves are the governing factor, and not the discount rate.

Mr. ERNST. May I interject a thought there, Senator?

Senator COUZENS. Yes.

Mr. ERNST. I would like to hear Mr. Greenidge on it.

Is it not true, Mr. Greenidge, if we estimate a relatively low reserve of oil that, as Senator Couzens has put it, there is immediately a higher value; that is, the reserve being low and conservative, that area of oil is measured by its market value after the cost and everything is deducted?

Mr. GREENIDGE. Yes.

Mr. ERNST. Now, that establishes immediately a depletion rate on every barrel of oil; if the production of that well is much higher than the original estimate of oil in reserve, then the company exhausts

entirely its charge for depletion, and it suffers in later years, because it has no depletion of that well?

Mr. GREENIDGE. Yes; because the regulations do not permit us to raise the value. A value once fixed may not be changed. We are not allowed to do that.

Mr. ERNST. The point I would like to make clear to Senator Couzens, and I am not sure whether I have, because his questions about the first value, and so forth, indicated that possibly it had not been made clear; but assume that I had 1,000,000 barrels of oil, reasonably well known, but a conservative owner put it in at 500,000 barrels. Your geologists knew all of the facts; they had the drilling records, the location, the area, and other wells in that territory. I was on a 500,000-barrel basis. That established my depletion rate for 500,000 barrels, but the minute I exhaust the 500,000 barrels my depletion for Government tax deduction would be entirely used up?

Mr. GREENIDGE. That is correct.

Mr. ERNST. And every barrel of oil beyond the 500,000 barrels which were initially established were then taxable at the entire rate, without deduction?

Mr. GREENIDGE. Yes; that is correct.

Mr. ERNST. Now, I am just wondering myself, because I would like to answer Senator Couzens's question, whether you can tell whether a man would profit by having a low estimate or a high estimate. I think it would be a very difficult question to answer, but I would like to have an answer to Senator Couzens' question.

Mr. GREENIDGE. That is what I said to Senator Couzens. I would want to submit that to a mathematical calculation before I would answer it, because a generalization on it might be dangerous.

Senator COUZENS. Just how far did the question of valuation, arrived at through the percentage discount, enter in as a factor of fixing valuations, do you know, Mr. Greenidge?

Mr. GREENIDGE. Yes, sir; it enters into every one.

Senator COUZENS. What other factors enter into arriving at the valuations, than the percentage and discount?

Mr. GREENIDGE. The lifting cost and the drilling campaign; that is to say, subsequent wells drilled after the first well, and, of course, any discoveries, for the market price of the oil at date of discovery.

Doctor ADAMS. What is the effect in that connection on the life of the property, Mr. Greenidge?

Mr. GREENIDGE. A very great one.

Doctor ADAMS. The shorter the life, the larger value given the production record?

Mr. GREENIDGE. Yes; because your discount factors increase as time goes on.

Doctor ADAMS. With a low reserve established, then, assuming a production record, it is a matter of experience, and not so much of estimate, and the low reserve would tend to increase the valuation, would it not, in that aspect, leaving aside for the moment the question of rate of return?

Mr. GREENIDGE. Yes; it would increase the value of that particular tract.

Doctor ADAMS. One other question there: Is not the measurement of the oil in the ground susceptible of reasonably exact estimate?

Mr. GREENIDGE. No, sir.

Doctor ADAMS. No, sir? I want to get you straight on that, because, while I do not think it will have much importance in this case, it will have very much importance with respect to discovery value. You say it is not susceptible of a reasonably accurate estimate?

Mr. GREENIDGE. No, sir.

Doctor ADAMS. Do you usually check the taxpayers' estimates of the oil in the well or in the ground?

Mr. GREENIDGE. It is not unusual. We always do.

Doctor ADAMS. Independently?

Mr. GREENIDGE. Yes, sir.

Doctor ADAMS. So that whether he estimates that he has much or little, it is not a question of his estimate, but of your check on your estimate?

Mr. GREENIDGE. No; because the bases he uses for arriving at his estimate are very important, and if he has used what one would call, in ordinary business, reasonable judgment and conservatism, and has taken into proper consideration the surrounding elements, his estimates of reserves would be very much more valuable as a check on the Government's figures than the man who had not taken those pains to really arrive at his ultimate recoverable oil.

Doctor ADAMS. Let me see if I understand you exactly. In the beginning, I understood you to say that you varied your interest rate a little, in accordance with the conservatism of the estimate of the oil in the ground.

Mr. GREENIDGE. And the peculiar conditions surrounding it.

Doctor ADAMS. And the peculiar conditions surrounding it. All right.

Mr. GREENIDGE. Yes, sir.

Doctor ADAMS. Now, if the taxpayer then sends in what you regard as a very excessive estimate of the oil in the ground you would, first of all, reduce that estimate, would you not?

Mr. GREENIDGE. Oh, yes.

Doctor ADAMS. If you are going to impose your estimate of the oil in the ground, why greatly vary the interest rate in accordance with that estimate; why not make your estimate of oil in the ground that which seems to be fair, right and equitable, and then use a stable interest rate?

Mr. GREENIDGE. The taxpayer wants to be heard on that subject. Before we could set up a fixed discount factor for any one field we would have to examine all of the estimate of the taxpayers in that field, and that would result in our being further behind in our work than we are now.

I hope I have made myself clear there, because the peculiar conditions under which each taxpayer operates are so peculiar that I do not think the word "peculiar" is strong enough.

Doctor ADAMS. Well, I can well understand how you might vary the rate of return in accordance with your judgment of all the conditions.

Mr. GREENIDGE. Yes.

Doctor ADAMS. That to me is very clear, but apparently when you check and use your own estimates of reserves, I am not certain that I do see why you should adjust your interest rate merely to vary with the reserves, because you can make that estimate as you want to; you can be very liberal or very conservative or intermediate.

Mr. GREENIDGE. I do not want to take up the committee's time with a discussion of this, but let me illustrate, and if the committee thinks I am carrying it too far, they can just say so.

Let us say we have two operators on one side of the line in a dangerous field; that is, a field on which the drop off is very rapid or irregular. A man on one side drills in a well and it is producing nicely. His rate of decline is normal. The man who owns the adjoining property, we, first of all, use a 10 per cent discount factor on him. After a month or two of production in this first tract the owner of the adjoining tract can come in, and he drills another well in what is known as an offset well. Certainly, the same rate of discount should not be applied to this second man as has been applied to the first man, because of the differences in his risk. This first man has gotten the benefit of the gas pressure, which is pushing his oil out. The first man has gotten the benefit of the rapid travel of the oil toward his well. The second man comes in, and he has to take his chances, first of all, of finding oil, with a reduced gas pressure.

Senator COUZENS. Therefore, you fix a lower discount rate?

Mr. GREENIDGE. No; higher. He is taking the risk in there.

Senator COUZENS. I know; but the lower the discount rate, the higher the valuation; is not that it?

Mr. GREENIDGE. No; not necessarily. The valuation is based on the ultimate recoverable oil.

Senator COUZENS. Yes; but in fixing the value of the property, the higher you get the value of the property, the bigger percentage of depletion allowed.

Mr. GREENIDGE. All things being equal, yes; because you are discounting at a less rate.

Senator COUZENS. That is what I say. So it is more desirable for an oil-well owner to have a low discount rate than a high discount rate.

Mr. GREENIDGE. Personally, if I were called upon to make a valuation of that kind for an oil operator, I would be very much inclined to use as small a discount factor as possible, if not disregard it.

Doctor ADAMS. What do you mean by "as small a discount factor as possible"?

Mr. GREENIDGE. Well, drop it down to the 4 or 5 or 6 per cent class.

Doctor ADAMS. Do you refer to the first owner or the second owner?

Mr. GREENIDGE. The first owner.

Doctor ADAMS. And in both cases you would estimate the quantity of oil there?

Mr. GREENIDGE. Yes; there is where I would do most of my work.

Doctor ADAMS. And consequently, in the case of the first well, the more rapid production would tend to shorten the life?

Mr. GREENIDGE. Oh, yes.

Doctor ADAMS. And the effect of shortening the life usually is to increase the value?

Mr. GREENIDGE. Yes; it is.

Senator KING. Have you not adopted this policy where sales of oil have taken place: Suppose a man acquired land, say, for a hundred thousand dollars. He drilled a well and sold it immediately after it came in for a million dollars or a million five hundred thousand dollars or two million dollars—and many wells, by the way, have been sold to the Standard Oil Co., as well as some independent companies, which have been brought in by private persons. That is true, is it not?

Mr. GREENIDGE. Yes, sir.

Senator KING. Is it not a fact that you would allow the person who drilled the well and who sold it for 10 or 20 times what it cost him a value wholly disproportionate to the cost of the property to him?

Mr. GREENIDGE. Yes.

Senator KING. As a result of which he paid practically no tax?

Mr. GREENIDGE. Of course, he is entitled to 20 per cent limitation under the statute if he made a discovery. I think I am correct in that.

Mr. ERNST. Would you amplify that a little, Mr. Greenidge?

Mr. GREENIDGE. Well——

Mr. ERNST. That means 20 per cent of the profit in that transaction?

Mr. GREENIDGE. Yes, sir.

Mr. ERNST. So that the law fixes the amount of the tax that would be paid in that transaction?

Mr. GREENIDGE. Yes.

Senator KING. What would be the maximum tax?

Mr. GREENIDGE. Twenty per cent of what he got, less what it cost him.

Senator KING. Assuming a case where he paid $100,000 and drilled a well, his expense being $100,000, or a total of $200,000, and he sold it for $1,000,000, you would only tax him, then, 20 per cent of $800,000?

Mr. GREENIDGE. Yes.

Mr. ERNST. That is in the law.

Mr. GREENIDGE. That is in the law. I think that is section 10 or 12 of the law.

Senator COUZENS. Do you know what the theory is of any such law as that, Professor Adams?

Doctor ADAMS. The theory of that limitation on that?

Senator COUZENS. Yes.

Doctor ADAMS. I know that very well, sir. It is meant merely to encourage prospecting and reduce the taxes on property derived by fortunate wild-catters who discover oil and sell it. I have that before me if you want it read.

Senator COUZENS. I do not think that is necessary.

Mr. ERNST. What is that section?

Doctor ADAMS. Paragraph B of section 211.

Mr. ERNST. That is the 1918 act?

Doctor ADAMS. Just a minute. I want to check that. That is correct.

Mr. ERNST. Of the 1918 act?

Doctor ADAMS. In the 1921 act it is found in the same place as in the 1918 act, and for the years following 1921 it is limited to 16 per cent.

Mr. ERNST. Doctor, may I clear up this point? That was a new provision in the 1918 act, limiting the tax on oil discoveries.

Doctor ADAMS. Yes; that was quite new in 1918, and was done with the deliberate purpose of encouraging prospecting.

Mr. GREENIDGE. It does not limit it to oil only. It limits it to mines also.

Senator KING. Who has charge of these records here?

Mr. GREENIDGE. I have.

Senator KING. The committee is discussing the propriety and wisdom of impounding those records by the Sergeant at Arms.

Mr. HARTSON. May it please the chairman, I would like to object to that. The committee's authority is to inspect the returns, made so by reason of the amendment to the regulations promulgated under an Executive order. Now, the companies have waived the right of privacy of these returns, and the bureau—I am speaking for the bureau now—feels that it must insist on retaining possession of its own records, permitting free inspection of them at any time when the committee is in session or at any other time; but certainly the bureau feels that we can not relieve ourselves of the responsibility of retaining possession of these records, and under the law which makes these returns public records, subject to inspection only under certain regulations.

Senator KING. The committee will go into executive session. We will send for Senator Watson and the other members and try to get a full committee here.

Senator COUZENS. Before we do that, I would like to ask Mr. Ernst another question.

He illustrated a case where an oil operator estimated the contents of a well at 500,000 barrels, for example, and the estimate was under the real contents of the well; so that when the 500,000 barrels had been exhausted, he would get no further depletion charge; is that correct?

Mr. ERNST. That is correct.

Senator COUZENS. That would act in this way, if I got it correctly: He would then get the benefit of his depletion charges during the high taxes, and take a chance of having a lower tax after the depletion had been all absorbed.

Mr. ERNST. That might reasonably follow with the changed tax rates.

Senator COUZENS. Yes; so that it would be good speculative judgment to make as low an estimate of the contents of the well as he could reasonably get away with.

Mr. ERNST. Well, Senator, I should not like to enter into a speculation. I wish to add here that the value schedules of each of those wells in the country are probably kept in finer detail by the Gulf Co. than by any other company it has been my privilege to know anything about, and we have had wonderful records in connection with their properties.

Senator COUZENS. I would like to ask Mr. Greenidge a question. When the Gulf Oil Corporation, as lessees, was allowed a depletion charge, were they allowed a hundred per cent of the depletion credit?

Mr. GREENIDGE. I do not get your question, Senator.

Senator COUZENS. When the Gulf Oil Corporation was allowed a depletion charge, as lessee, was it allowed the full depletion charge, or was it divided between the lessor and the lessee?

Mr. GREENIDGE. Oh, only such portion of it as applied to their ownership; that is, if they owned seven-eighths, or a half, only such portion as applied to them.

Senator COUZENS. Then, the other was allowed to the lessor?

Mr. GREENIDGE. Yes; the other part of it.

Senator COUZENS. In other words, there was no opportunity for for allowing a full depletion charge to the lessor and to the lessee, too?

Mr. GREENIDGE. Oh no, no; the statute stating that the depletion must be divided equitably.

Senator COUZENS. Mr. Hartson, how far have you got the returns of the Gulf Oil Corporation here; I mean up to what year?

Mr. HARTSON. I can not answer that.

Mr. LINZEL. Up to and including 1919.

Senator COUZENS. You have not the returns then, for 1920, 1921, or 1922?

Mr. HARTSON. I doubt if the audit has been completed on those.

Mr. LINZEL. 1920 was not completed.

Mr. HARTSON. The portion that has been brought up is the portion that has been completed and the settlement closed.

Senator COUZENS. And which has reference to the refund which was discussed?

Mr. HARTSON. Yes; that is correct. There has been no refund since that time, as far as I know.

Doctor ADAMS. Mr. Ernst, this particular audit of these cases was rather hurried and rushed to get it out of the way before Secretary Mellon entered the Cabinet, was it not?

Mr. ERNST. I think there might be something of that considered here, but I wish to call your attention to the fact that I had arranged with Mr. Roper and Mr. Callan to hurry these cases through on purely the financial matters that were involved, and our work was speeded up with that thought in mind solely; that is to say, I had absolutely no intimation that Secretary Mellon would become a member of the Cabinet, or anything else. It did not come into my work. I was employed to hurry these cases through special arrangement with Mr. Roper to have it done.

Doctor ADAMS. Who was the Commissioner of Internal Revenue when the A–2 letter was sent?

Mr. ERNST. I believe it was Mr. Williams. I may be wrong about that.

Mr. HARTSON. I think it was Mr. Williams.

Mr. ERNST. Yes; it seems to me that Mr. Roper had left, and Mr. Williams was in there for a short time.

Senator COUZENS. Answering Doctor Adams, I do not think there is any question about that, because Colonel Drake either testified before the committee or told me personally that every effort was made to dispose of the matter before Secretary Mellon came in.

Doctor ADAMS. My interest in it was due to the fact that it seemed to be a rather short interval, a three-year tax adjustment after the auditors finished the work, but Colonel Drake had so stated.

Mr. ERNST. In answer to that point, Doctor Adams, an oil company, taking oil out of the ground and selling it, is quite different from a manufacturing business. I mean, if you get your basis established for depletion, depreciation, and all the other factors, it is not very difficult to carry that work through. So far as my work was concerned I had been employed to hurry this matter and get it settled. Personally, I may say that I never was approached about hurrying it because of Secretary Mellon taking his position in the Cabinet. I hurried it from early in 1920.

Senator KING. You will not be here to-morrow, Mr. Ernst?

Mr. ERNST. I was very hopeful that I could go to New York to-night. There are some people from Richmond, Va., who are going there to see me, and I told them I would meet them there to-morrow.

Senator KING. You can come back?

Mr. ERNST. Oh, yes; I can come back.

Senator COUZENS. But it will not be necessary to come back this week.

Senator KING. No.

Mr. ERNST. I am perfectly willing to phone them and say that it is necessary for me to stay here.

Senator KING. I would prefer not to do that, because the Finance Committee meets, the full committee, and I have two other committees. As I have had to be in attendance on those committees to-day, I have not had time to hear your testimony and I must have a transcript of the reporter's notes before I can cross-examine you intelligently.

Mr. ERNST. I regret, Senator, that you were not here, because I am afraid that in reading these minutes you will find that Senator Couzens, possibly, has created the impression that I was evasive sometimes, and I wish to say to you that my instructions have been to be absolutely frank and to give you everything, and that is my earnest desire.

Senator KING. Well, if the record creates a wrong impression, you can easily dissipate it.

Mr. ERNST. Well, with that word, I know you will keep it in mind.

Senator KING. We will excuse you, gentlemen. Mr. Hartson can remain in the room for a moment.

Mr. ERNST. May I ask whether it is entirely agreeable, Senator Couzens, that I go away to-night?

Senator COUZENS. Oh, yes; we will let you know some day next week. I am not quite ready to go ahead with your examination myself. We will give you plenty of notice.

Mr. ERNST. I thank you very much.

(Whereupon, at 5 o'clock p. m., the committee went into executive session, after which an adjournment was taken until Monday, March 31, 1924, at 2 o'clock p. m.)

BUREAU OF INTERNAL REVENUE

MONDAY, MARCH 31, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met pursuant to adjournment at 2.30 o'clock p. m., Senator James E. Watson presiding.

Present: Senators Watson (chairman), Ernst, and Couzens.

Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. N. T. Hartson, Solicitor Internal Revenue Bureau; and Mr. S. M. Greenidge, head engineering division, Internal Revenue Bureau, and Dr. T. S. Adams, tax expert, Yale University.

The CHAIRMAN. The committee will be in order.

Senator COUZENS. I would like to have Mr. Greenidge take the stand and be sworn.

TESTIMONY OF MR. S. GREENIDGE, HEAD ENGINEERING DIVISION, INTERNAL REVENUE BUREAU

(The witness was sworn by the chairman.)

Doctor ADAMS. Mr. Greenidge, had you not better state again, for Senator Watson's information, your position at the Bureau of Internal Revenue?

Mr. GREENIDGE. I am head of the engineering division of the Income Tax Unit.

The CHAIRMAN. How long have you held such position?

Mr. GREENIDGE. I have been head of the engineering division about 10 months, and I have been in the bureau about three years and a half.

The CHAIRMAN. In the same division?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Are you a civil-service employee?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. You went into the bureau under the previous administration, then?

Mr. GREENIDGE. Yes, sir; I came in on October 4, 1920, I think, to be exact.

Senator COUZENS. When we adjourned on last Thursday, you were to look up some figures in particular showing the gains by the Gulf Oil Corporation as a result of allowing the lessee depletion.

Mr. GREENIDGE. Yes, sir; I think I have those figures for you.

The amount allowed in the year 1916 on account of the leasehold was $1,750,000, and on fee properties, $268,000. The round numbers are sufficient, I take it?

Senator COUZENS. Yes.

Mr. GREENIDGE. And in 1917, $1,690,000 for leaseholds and $234,000 for fee properties.

Senator ERNST. For what kind of property?

Mr. GREENIDGE. For fee properties—properties that are held in fee.

Senator ERNST. Oh, yes.

Senator COUZENS. Will you proceed and give us the figures for the rest of the years?

Mr. GREENIDGE. Did you wish them for other years?

Senator COUZENS. We wanted them for the whole period.

Mr. GREENIDGE. For 1918, it would become allowable under the law.

Senator ERNST. As I understand you, that is the method that was pursued in 1916 and 1917, which was enacted into law in 1918; is that the idea?

Mr. GREENIDGE. It was authorized by a Treasury decision in 1922.

Senator ERNST. How about 1918? I thought your statement was in reference to that.

Mr. GREENIDGE. Yes; it was enacted into law in 1918. The revenue act of 1918 carried that provision.

Senator COUZENS. How do you account for the lapse of time between the 1918 law and the promulgating of the rule by the department in 1922?

Mr. GREENIDGE. The matter had been under discussion for some time prior to my becoming connected with the department, and I think was submitted to the Solicitor's Office sometime during the year 1921. Perhaps Mr. Hartson could give you the detailed history of that better than I could, Senator.

Senator COUZENS. We will delay that answer then until Mr. Hartson comes on, because we want to ask him some more questions.

Will you proceed now and tell us what the depletion charges on leaseholds were during the years 1918, 1919, and 1920, etc.?

Mr. GREENIDGE. In 1918, on discovery, $10,400,000; 1919, $10,590,000.

The CHAIRMAN. Let me ask you this question, please: Between 1918, when the previous policy had ripened into law and 1922, when that policy was promulgated by the Treasury Department, what policy did you pursue?

Mr. GREENIDGE. Some of the cases were closed allowing depletion to the lessee. Some were closed disallowing it, and the very large majority were held pending decision.

The CHAIRMAN. Are they still pending?

Mr. GREENIDGE. No; they were pending, sir.

Doctor ADAMS. May I interrupt right there?

The CHAIRMAN. Yes.

Doctor ADAMS. The law in 1918 and thereafter plainly allowed the lessee depletion. The only years really involved are prior to 1918. That is, the Treasury decision of August, 1922, was a retroactive decision in its effect, applying to years earlier than 1918, but as to the year 1918 and thereafter, there was no legal question.

Senator COUZENS. As I get it from these figures, during the years 1916 and 1917, and prior to the law fixing a depletion charge for leaseholds, you allowed the Gulf Oil Corporation some $3,500,000 for depletion on leaseholds; is that correct?

Mr. GREENIDGE. Yes, sir; the figure is very close to correct.

Senator ERNST. Are you making any objection to that, if the same rule were followed with regard to other companies?

Senator COUZENS. I am coming to that, if you do not mind, Senator.

Senator ERNST. All right.

Senator COUZENS. Can you tell us how many cases in which you applied that same rule for the years 1916 and 1917, other than the Gulf Oil Corporation?

Mr. GREENIDGE. I can not tell you all of them, Senator, because our search has not yet been completed. It has been a rather big piece of work, but we have found a number; up to now, we have found twenty-odd, some of which were allowed and audited, passed through the audit process as well as the valuation.

The CHAIRMAN. What was the nature of those cases?

Mr. GREENIDGE. They were oil cases.

The CHAIRMAN. All oil cases?

Mr. GREENIDGE. Yes, sir; Ohio, Oklahoma, California, Pennsylvania, West Virginia, and New York.

The CHAIRMAN. Can you give us the names for the record?

Mr. GREENIDGE. With your permission, I will consult with the solicitor.

The CHAIRMAN. Yes.

Mr. GREENIDGE. As to whether the names should be given?

Mr. HARTSON. I think there is no objection to giving the names if the amounts of the taxes are not referred to.

Mr. GREENIDGE. Well, I have not the amounts of the taxes, anyway. I purposely avoided recording that until it was asked for.

The CHAIRMAN. Yes.

Mr. GREENIDGE. Shall I give you the names that we found so far, sir?

Senator COUZENS. Yes, sir; that is, that have been settled on this same basis and according to this same policy.

Mr. GREENIDGE. B. F. Whitehill, Columbus, Ohio.

Doctor ADAMS. That is an individual taxpayer?

Mr. GREENIDGE. An individual; yes, sir. Dorris Oil & Gas Co., Tulsa, Okla. Those were complete in their entirety. Lasoya Oil Co., Altoona, Pa.; Jacob Stelzer, Spencerville, Ohio; Hyde Carbon Black Co., Ridgway, Pa.; Paul Lovell, Marietta, Ohio; W. T. Hastings, Marietta, Ohio; Nevada Petroleum Co., San Francisco, Calif.; Dental Oil Co., Sistersville, W. Va.; Premium Oil Co., Franklin, Pa.; Big Fifty Oil Co., Tulsa, Okla.; D. T. Andrus, Rixford, Pa.; Boston Petroleum Co., Boston, Mass.; Warner Oil Co., Titusville, Pa.; Paraffin Oil Co., Bakersfield, Calif.; and Southwestern Petroleum Co., Buffalo, N. Y.

That is the statement of those which were completed, even through the process of auditing and sending out the final assessment letter or over-assessment letter, as the case may have been.

Senator ERNST. They were completed when?

Mr. GREENIDGE. Prior to the promulgation of Treasury Decision 3386, August, 1922.

Senator ERNST. Were not most of those cases, if not all of them, settled while Mr. Williams was Commissioner of Internal Revenue and

while Mr. Houston was Secretary of the Treasury? I am referring to those that you have named.

Mr. GREENIDGE. All but two, sir.

Senator ERNST. That is all.

Senator COUZENS. The case of the Gulf Oil Corporation was also settled by the administration prior to Mr. Mellon's assuming office, too, was it not?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Now, can you tell us how many cases there were in which depletion for leasehold was denied?

Mr. GREENIDGE. No; I could not tell you that, Senator, without a considerable search of the files.

Senator COUZENS. Well, it is a fact that there were quite a number, is it not?

Mr. GREENIDGE. Oh, yes.

Senator COUZENS. That were denied.

Mr. GREENIDGE. Yes.

Senator COUZENS. Can you explain why the Treasury Department should deny a depletion to leaseholds in some cases and allow it in others?

Mr. GREENIDGE. At that time, prior to the middle of 1921, the department was in its formative stage, and some difference of opinion existed among the employees as to the correct determination of the depletion allowance and its application to the ultimate tax settlement. The revenue act mentioned the decline in flow method as being the one to use in determining depletion, that had caused a great deal of comment, and had not yet been decided. The allowability of it was partially decided. The amount of the depletion was also determined, but its application had not been entirely decided upon by those in authority or those in a position to do so, and that I think will explain better than any other thing tha tI can say, according to my knowledge.

Senator COUZENS. In cases where there was no depletion allowed to the lessee, was the entire depletion allowed to the lessor?

Mr. GREENIDGE. No.

Senator COUZENS. Was there any controversy that developed in the department when a division of the depletion charge was arranged between the lessor and the lessee?

Mr. GREENIDGE. Yes; a very considerable controversy, even among the employess themselves—men who had nothing whatever to do with the amounts involved.

Senator COUZENS. As a matter of fact, then, outside of this some twenty odd cases in which the lessee was allowed a depletion credit the lessor got all of the depletion credits?

Mr. GREENIDGE. No; he only got his proportionate part. Suppose the lessor got a royalty of one-eighth of the production, he only got one-eighth of the depletion allowable.

Senator COUZENS. Then, the Government retained for the Treasury the seven-eighths of the depletion credit that belonged either to the lessor or to the lessee?

Mr. GREENIDGE. Yes; until the taxpayer made protest.

Senator COUZENS. And if the taxpayer had made no protest, then he was out?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. The depletion credit for the proportion that would ordinarily have been allowed the lessee; he was out that amount?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. And no notice was served on these oil companies of the change of method or of the division of opinion that existed in the Treasury Department?

Mr. GREENIDGE. No notice was served on them, but it was so generally known that notice was unnecessary. All who were interested, I might say, knew that it was a matter under discussion, and they did not, for that purpose and other purposes, present their final request for that settlement.

Senator COUZENS. Now, in all of these cases where the depletion credit to the lessee was denied, have these companies since made claim for depletion?

Mr. GREENIDGE. Oh, yes; I should say practically all.

Senator COUZENS. And are those cases settled?

Mr. GREENIDGE. Most of them. Yes; nearly all. All except a few of the larger ones.

Senator COUZENS. What is holding up the larger ones?

Mr. GREENIDGE. The settlement of other points in controversy. This point is no longer in controversy, of course.

The CHAIRMAN. What do you mean by that? What is your policy now in reference to that? You do not hold up the taxes now?

Mr. GREENIDGE. Oh, no.

The CHAIRMAN. Do you notify the person interested?

Mr. GREENIDGE. Yes. Whether he has claimed it or not, he is allowed it.

Doctor ADAMS. You would not notify the taxpayer?

Mr. GREENIDGE. No; we simply allow it, and it goes on to audit as if the taxpayer had claimed it.

Doctor ADAMS. If the taxpayer who was denied lessee depletion, does not raise the question, you will not raise it on his behalf?

Mr. GREENIDGE. Not at that time.

The CHAIRMAN. No; at this time.

Mr. GREENIDGE. At the time his taxes are being readjusted for another year, and it is evident that he has not gotten credit for it, of course, he would be granted it.

The CHAIRMAN. Whether he makes claim or not?

Mr. GREENIDGE. Whether he makes claim or not.

The CHAIRMAN. But it did not use to be that way?

Mr. GREENIDGE. No.

The CHAIRMAN. In other words, he was out, if he did not make a claim?

Mr. GREENIDGE. Yes.

Doctor ADAMS. Unless the taxpayer himself makes claim, it is not practicable to give him his rights, is it?

Mr. GREENIDGE. Oh, yes; it is; and we are trying to do it in nearly every case we can. Of course, some deductions are so vaguely specific in a taxpayer's return, that we can not know what they are for; but where we know what they are for, we see that the taxpayer is granted what is coming to him; and in the later days, we are even inviting a claim where they do not know of their rights in regard to such claims

Doctor ADAMS. You said a moment ago that a number of taxpayers who were denied lessee depletion have later received it. Can you name some of those companies who were denied it in the first instance, and later received it?

Mr. GREENIDGE. Offhand I could not; no.

Doctor ADAMS. I was wondering whether you had a list of those claims, of those who had been denied lessee depletion.

Mr. GREENIDGE. No; I have not.

Doctor ADAMS. Then your statement is one of general policy?

Mr. GREENIDGE. Yes. To get such a list, Doctor Adams, would entail a great deal of work which, of course, we are quite willing to do and anxious to do, if necessary.

Doctor ADAMS. Well, I would like to bring out this point: My experience is that the department is ready and willing to grant a claim, if the taxpayer does not make one, when the department is able to discover it; but, in general, you can not discover all such things for the taxpayer.

Mr. GREENIDGE. No; we can not discover them all.

Doctor ADAMS. Well, you can not discover any large proportion of them, can you?

Mr. GREENIDGE. I think we do. I think we discover the majority—the large majority.

Doctor ADAMS. I mean he has to get expert aid. If he does not himself raise the question, it is not raised for him—not because the department is not willing to raise it for him but because it does not discover it.

Mr. GREENIDGE. Yes; that is true.

Doctor ADAMS. That is the point I want to make.

Senator COUZENS. Do you know who drafted the oil regulations for the department?

Mr. GREENIDGE. A large group of experts were brought here, I think, in the latter part of 1918 or the early part of 1919, from all over the country. If my memory serves me correctly, there were some ninety of them, Senator, and, as a result of extended conferences, they got up what was known as the first oil and gas manual, and some of those men assisted in the drafting of the first and second regulations.

Senator COUZENS. You refer to the first and second regulations. How many sets of regulations were drafted?

Mr. GREENIDGE. We have 33 here; 45, 45 amended, and 62; 33 under the 1917 act or regulations for the 1917 act; 45 and 45 amended for the 1918 act and 62 for the 1921 act.

Senator COUZENS. Do you know who the guiding spirit was in the formulating of those oil regulations?

Mr. GREENIDGE. I could not say with definiteness, but I think a man by the name of Ralph Arnold, of California, was the chairman of the committee. I am not sure about that, but I think he was; at least, he was among the leading spirits.

Senator COUZENS. Did he work with the employees of the department in formulating these rules and regulations?

Mr. GREENIDGE. I think so, sir. That was before my time, but from what I have heard of it, I am pretty sure that he did. Then, in conjunction with that, a number of these men had been brought on or were asked to come on here to do it as a patriotic matter. I

do not think they were paid; I am not sure about that, but I do not think they were paid for their services.

Senator COUZENS. Was Mr. Wayne Johnson in the department when you came here?

Mr. GREENIDGE. I think not, sir. I could not state with certainty.

Senator COUZENS. Do you know Mr. Wayne Johnson?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. What does he do now?

Mr. GREENIDGE. He is an attorney in New York.

Senator COUZENS. Is he anything else besides an attorney?

Mr. GREENIDGE. Not as I know of, Senator—representing a variety of clients, I suppose.

Senator COUZENS. Did you work with the staff of the Gulf Oil Corporation in getting this settlement which was closed up prior to Mr. Mellon's taking the secretaryship?

Mr. GREENIDGE. No, sir; I did not know them, even. I had not become acquainted with them.

Senator COUZENS. Do you know who, in the department, worked with the officials or the experts of the Gulf Oil Corporation?

Mr. GREENIDGE. Who are now in the department, Senator?

Senator COUZENS. Yes.

Mr. GREENIDGE. I do not think there are any, Senator. I am pretty sure there are not.

Senator COUZENS. In other words, you are pretty sure that all of the employees of the department who aided in the settlement of the Gulf Oil Corporation case have since left the bureau?

The CHAIRMAN. He is his brother-in-law, is he not?

Mr. GREENIDGE. I think that is it. It is some such relationship, from what I have heard. I do not know of my own knowledge.

Senator COUZENS. Does Mr. Mapes practice before the department now?

Mr. GREENIDGE. He does.

Senator COUZENS. Does Mr. Johnson practice before the department?

Mr. GREENIDGE. He does.

Senator COUZENS. Do both of these gentlemen practice before the department mostly in oil cases?

Mr. GREENIDGE. I do not think either of them has appeared in oil cases; at least, not as far as I know. Neither of them has appeared before the Engineering Division in an oil case.

Senator COUZENS. Who succeeded Mr. Mapes as solicitor?

Mr. GREENIDGE. Mr. Hartson.

Senator COUZENS. The present solicitor?

Mr. GREENIDGE. The present solicitor.

Senator COUZENS. Have you any record showing when and how the Gulf Oil Corporation asked to have their claims closed under section 1312?

Mr. GREENIDGE. Yes; I have knowledge of their having asked it at some time, I should say, last summer.

Senator COUZENS. What do you mean by "last summer?" About what time?

Mr. GREENIDGE. I could not be exact, Senator.

Mr. GREENIDGE. As regards the engineering end of it, Senator.

Senator COUZENS. You think that is correct?

Mr. GREENIDGE. I am pretty sure that is correct.

Senator ERNST. Do you know their names? Can you state them for the record?

Mr. GREENIDGE. Of those who had ——

Senator ERNST. Those who you think had something to do with it and who have since left.

Mr. GREENIDGE. Yes; Mr. C. F. Powell was acting chief of the section, and Mr. Burr McWhirt, I think, was the engineer who checked the figures. I do not think any other engineers had anything to do with it.

Senator ERNST. But you had nothing to do with it?

Mr. GREENIDGE. No, sir.

Doctor ADAMS. Was this refund submitted to the then Solicitor?

Mr. GREENIDGE. I presume so.

Doctor ADAMS. You do not know from the record whether it was or not?

Mr. GREENIDGE. I am pretty sure it would have been, though, because every other refund was submitted to him, above a certain amount.

Senator COUZENS. Who was the then Solicitor?

Mr. GREENIDGE. The first Solicitor, Senator Couzens, that I remember anything about was Mr. Mapes.

Senator COUZENS. Is he any relation to Wayne Johnson, that you know of?

Mr. GREENIDGE. Not that I know of, but I have heard it said that he is related to him.

Senator COUZENS. Was it not the fact that this application for closing the Gulf Oil Corporation case under section 1312 was after Mr. Harding's death?

Mr. GREENIDGE. It was thereabouts. It was either after or shortly before. I could not tell you with certainty, the exact date.

Senator COUZENS. In other words, nearly a year had expired before the closing of the case?

Mr. GREENIDGE. Oh, yes; a considerable time had expired after the closing of the cases.

Senator COUZENS. Does Mr. Hartson remember offhand what the other things are that the bureau was to submit?

Mr. HARTSON. Yes; Senator Couzens. I would like to have Mr. Greenidge, if agreeable to the committee, explain with reference to those sums of money he testified to as having been the amount allowed in depletion, how they affected the tax, if he has those figures.

Mr. GREENIDGE. Yes; we have those figures. I will have to call on the auditor to furnish that information.

Mr. HARTSON. I do not want the committee to get the impression that the sums of money referred to by Mr. Greenidge are the amounts of money refunded because of the allowance for depletion to the company.

Senator ERNST. I think that is the impression that was created. What is the fact about that?

Mr. HARTSON. I will ask Mr. Greenidge to explain that.

Mr. GREENIDGE. That these sums that I have mentioned were refundable sums?

Mr. HARTSON. Yes.

Mr. GREENIDGE. No; they were not. They were the amounts allowed as deductions from gross income.

Senator COUZENS. That is the way I understood it. Perhaps the other Senators did not understand it that way.

Mr. HARTSON. Now, Senator Couzens, there was some discussion here last Thursday afternoon as to that 5 per cent basis that was used in connection with the Gulf Oil Corporation in this settlement, and there was some criticism of that. I think Mr. Greenidge has something on that that may be of interest to the committee.

Mr. GREENIDGE. You asked for some information to be supplied the committee on that point, Senator Couzens, and I thought we would make an effort to present it in such a way that it would be easily understandable.

Senator COUZENS. Before you go into that, could you say how many cases were settled on a 5 per cent basis?

Mr. GREENIDGE. No, sir; I could not.

Senator COUZENS. Were there many of them?

Mr. GREENIDGE. Very few that I know anything of.

Senator COUZENS. Were not most of them settled on a 10 per cent basis?

Mr. GREENIDGE. Where the analytical appraisal method is used; yes, sir.

Senator COUZENS. Does the information that you propose to give to the committee, as suggested by Solicitor Hartson, show the relative benefits to the taxpayer from applying the 5 per cent basis as contrasted with the 10 per cent basis?

Mr. GREENIDGE. I think so, Senator. I prepared it with that in view.

Senator COUZENS. Then you may proceed.

Mr. GREENIDGE. More as a matter of general information, which may tend to clear up the ideas of the committee, as I understand them. I think in the last session I tried to stress the fact that the estimate of ultimate recoverable oil was the important thing in oil reserves and not the discount factor.

Now, Senator King, in his discussion, mentioned that a well coming in at 5,000 barrels per day should be multiplied by the 365 days in a year to show its ultimate production, and I have prepared this curve to show the committee that that is not the case.

A well comes in at 5,000 barrels per day, we will say, starting here and its drop off is very rapid, so, we will say, it is 5,000 here, and at the end of the year it is probably less than 2,000.

Senator COUZENS. Because of the lack of gas pressure?

Mr. GREENIDGE. Because of the lack of gas pressure. This is purely a general curve. It has been prepared for the purpose of demonstrating what actually does happen, and it has been specially prepared to show a well whose ultimate production is 500,000 barrels. That is all the oil that you can commercially get out of this well on this curve will be 500,000 barrels, and it will last 10 years. In the first year it will produce 240,000 barrels; the second year 120,000 barrels; the third year 60,000 barrels, and so on down as the curve drops down.

Senator COUZENS. Do you consider a well that produces a thousand barrels of oil per year a commercial well?

Mr. GREENIDGE. In some fields it is what we know as the economic limit, Senator, but in a great many fields they go below that. For instance, some of the wells in the Bradford field, Pennsylvania, produce as little as one-tenth of a barrel per day, or less than 40 barrels per year and still they pump them. Of course, with deep wells, and a low quality of oil, you can not carry them to that extent.

Senator COUZENS. Is this all of the information that you have in that connection?

Mr. GREENIDGE. I have two sets of figures which I have prepared for the 500,000 barrel well and for the million barrel well to which I referred the other day.

A compound discount of 5 per cent on that well shows a composite discount factor of 9.66 per cent. I would like to explain there——

The CHAIRMAN. What does that mean?

Mr. GREENIDGE. That is what I was coming to now, Senator.

The CHAIRMAN. All right.

Mr. GREENIDGE. If you were to loan me money, and if at the end of a year I were to return you a dollar, you could not afford to loan me a dollar. You could only afford to loan me 95 cents, and if I would likewise return you a dollar at the end of two years, you could only now loan me 90 cents, and so on. If I am going to return you $1 at the end of 10 years, you can only afford to loan me 61 cents to-day.

The CHAIRMAN. That is calculated on the 5 per cent basis.

Mr. GREENIDGE. Five per cent compound.

The CHAIRMAN. Yes.

Mr. GREENIDGE. The first year's production of these wells, as I have shown you, is likewise larger than any other year, except in one instance only, in Mexico. The production of the first year is multiplied by 95 per cent, or the 95 cents on the dollar to which I have just referred.

The CHAIRMAN. Yes.

Mr. GREENIDGE. In the second year your production is very much less, and the present worth of that dollar is very much less. It is 90 cents. That is carried on down until the last year's production of a thousand barrels is only worth to-day 61.4 cents per dollar. The summation of the results of value, multiplying production by the present worth factor, gives you a total present worth of the value of the oil at the date on which you are doing your valuing.

The CHAIRMAN. For taxable purposes?

Mr. GREENIDGE. Or for loan purposes.

The CHAIRMAN. I understand, but we are talking about taxable purposes now.

Mr. GREENIDGE. Yes. That is income. Now, if you had 500,000 barrels of oil in the ground at the date of estimate, or at the date on which you started into the business, either as a loan, or to extract it, or otherwise, if your yield was 500,000 barrels at that date, you may have sold it for $500,000 and that would have been your present worth; but you are getting a lessening proportion from that well per year, which is also worth a less amount of money every year, and the present worth of that 500,000 barrels, extracted at that rate, as I have shown by the curve, is only $451,682, and your reduction there, your composite discount there is 9.66 per cent.

The CHAIRMAN. Do you use that arbitrary formula in determining the taxable value of every oil well?

Mr. GREENIDGE. Oh, no. That is only for the analytical appraisal.

The CHAIRMAN. Do you take into consideration the quantity of oil actually produced?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. And the value of it?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. You have to do that?

Mr. GREENIDGE. Yes. That is the important thing.

The CHAIRMAN. Yes.

Mr. GREENIDGE. That is why we raised that question at the last estate of the recoverable oil.

The CHAIRMAN. When you use this formula, and when you get the actual value, of what use is this formula to you in arriving at the basis of taxation in regard to an oil well?

Mr. GREENIDGE. It sets up a value of the present worth of oil, estimated in the ground, for the purpose of figuring the depletion unit. It is nothing more or less than the application of a banking principle.

Senator ERNST. On this curve which you have been talking about of 240,000 barrels the first year, you have filed a statement, which I will read: The first year, 240,000 barrels; the second year, 120,000 barrels; the third year, 60,000 barrels; the fourth year, 36,000 barrels; the fifth year, 20,000 barrels; the sixth year, 12,000 barrels; the seventh year, 6,000 barrels; the eighth year, 3,000 barrels; the ninth year, 2,000 barrels, and the tenth year, 1,000 barrels. Is that correct?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Is that your experience in actual practice, or is that a hypothetical case?

Mr. GREENIDGE. It is a hypothetical case.

Senator COUZENS. And it does not follow the practice?

Mr. GREENIDGE. It does not follow exactly the practice, because each well has a different curve, or each area has a different curve, I should better say.

Senator COUZENS. That is not a standard, then, of what might be experienced?

Mr. GREENIDGE. You could not call it a standard exactly, but it is a good indicator.

Senator ERNST. Then, you change your figures in accordance with the character of the oil well, do you not?

Mr. GREENIDGE. Oh, yes. For instance, in the Ranger field in Texas the production the first year would be more nearly 90 per cent, while with this well the production is approximately 48 per cent in the first year.

Senator ERNST. That is what I wanted to get.

Mr. GREENIDGE. Some wells drop off much more rapidly than others.

Senator COUZENS. Now, in this particular hypothetical case which you have presented, what is the credit for each of those years on a 5 per cent basis?

Mr. GREENIDGE. The depletion unit for this well will be approximately 90 cents. I do not suppose you are interested in the exact

figures. It was 90 cents per barrel. Now, in the first year, the depletion that would be allowed to the taxpayer would be its production that year, 240,000 barrels, multiplied by 90 cents.

Doctor ADAMS. What year are you referring to there?

Mr. GREENIDGE. The first year's production. He would be allowed $216,000 depletion.

Senator COUZENS. Right at this point, in order that we may get it clearly in our minds, assume that you were using a 10 per cent basis. What would be the depletion and credit for that year?

Mr. GREENIDGE. The depletion unit first would be 82 cents—I am only carrying it to cents—and that would be 240,000 times 82, or $196,800.

Senator COUZENS. Against how much on the 5 per cent basis?

Mr. GREENIDGE. $216,000.

Senator COUZENS. So that when the department fixes a percentage basis of 5 per cent, the oil operator, the taxpayer, in the 5 per cent case, would receive a depletion allowance of $216,000, and if you insisted on 10 per cent he would receive a depletion credit of only $196,000?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. So that there is quite a large advantage to have the department allow a 5 per cent basis, instead of a 10 per cent basis; is not that correct?

Mr. GREENIDGE. Other things being equal.

Doctor ADAMS. Your illustration applied to the first year?

Mr. GREENIDGE. Yes. We were just talking about the first year.

The CHAIRMAN. Well, would the same proportion of advantage apply all the way through for the various years?

Mr. GREENIDGE. Practically; yes, sir.

The CHAIRMAN. How do you determine whether to use the 5 per cent basis or a 10 per cent basis?

Mr. GREENIDGE. Depending on the circumstances surrounding the valuation of the property, the amount of risk, and the various factors that enter into the valuation. There are instances in which we do not use any discount factor whatever. Where the taxpayer presents a reasonable valuation, there is no discount factor applied. A great many taxpayers do not apply a discount factor at all.

The CHAIRMAN. In the Gulf Oil Corporation case that you have been talking about, you applied that factor?

Mr. GREENIDGE. Yes.

The CHAIRMAN. What was there peculiar in that case that caused you to apply that basis and not to apply it in other cases?

Mr. GREENIDGE. Their decline curves—I am speaking now from what I have heard from engineers who worked on the case before they left the department—were so conservatively constructed that the 5 per cent or 10 per cent, or any other discount factor, was not a material point in the case.

Senator ERNST. So that, after all, each case has to a greater or less extent to stand on its own bottom?

Mr. GREENIDGE. It has to. The law so specifies, Senator.

Senator ERNST. That is what I understood.

Mr. GREENIDGE. That is why I have prepared two sets of figures showing the 1,000,000-barrel estimate and the 500,000-barrel estimate, because the 1,000,000-barrel estimate shows a returnable cap-

ital sum of $903,000 and the 500,000-barrel estimate only shows a capital return of $451,000, or just one-half.

Senator COUZENS. Is the Gypsy Oil Co. a subsidiary of the Gulf Oil Corporation, do you know?

Mr. GREENIDGE. Yes, sir. I file this chart simply as illustrative.

The CHAIRMAN. Yes; surely.

Mr. GREENIDGE. We purposely took no special case.

Doctor ADAMS. Did you apply the 5 and 10 per cent factors to these particular reserves in any year, particularly in 1916 and 1917?

Mr. GREENIDGE. In all years they were applied; yes, sir.

Doctor ADAMS. Did you apply both, so that you could measure the extent of the difference?

Mr. GREENIDGE. No; I have not. You are referring now to the Gulf Oil Corporation case?

Doctor ADAMS. What difference would it make for 1916 and 1917 if a 10 per cent basis or the 5 per cent basis were used?

Mr. GREENIDGE. In 1916 it would have made an immaterial difference because of the 2 per cent tax.

The CHAIRMAN. Did the Gulf Oil Corporation have an amortization claim?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. What became of that?

Mr. GREENIDGE. That was disallowed. They made it as a claim, but it was not substantiated by the data that the department calls for to be submitted in connection with the allowance of such a claim. That claim amounted to $1,198,590.89.

The CHAIRMAN. Was there any portion of it that was allowed?

Mr. GREENIDGE. None of it.

Mr. NASH. May I ask Mr. Greenidge a question there?

The CHAIRMAN. Yes.

Mr. NASH. Could that claim have been substantiated, in your judgment, if the case had not been expedited?

Mr. GREENIDGE. Yes. I do not think my judgment needs to be taken on that, either. It is a fact. It could have been.

Mr. NASH. Well, if it could have been substantiated, why did they not submit it? Was there anything said about it when they filed it?

Mr. GREENIDGE. To my knowledge, I could not answer that, but I understand it was in order to get the matter settled up and out of the way.

Senator COUZENS. Before Mr. Mellon became the Secretary of the Treasury?

Mr. GREENIDGE. Yes.

The CHAIRMAN. Yes; that is what I understood.

Mr. NASH. What relation did the amount of amortization bear to the difference that was made in that tax as a result of this depletion charge?

Mr. GREENIDGE. I would have to refer to that.

Senator COUZENS. Have you the record of that amortization charge here?

Mr. GREENIDGE. Yes, sir. I have the total figure. I have not the claim before me, but the total figure is $1,198,590.89.

Senator COUZENS. You mean that is the amount of the allowance claimed?

Mr. GREENIDGE. Claimed.

Senator COUZENS. What effect would that allowance have had upon the tax had the amortization not been allowed?

Mr. GREENIDGE. It would have meant a material reduction. I do not know according to what surtax brackets the Gulf Oil taxes were finally figured, but I presume they were high. I could not say offhand what per cent.

Mr. NASH. What I want to bring out is this, and I will put my question in this way: Would the amount recoverable, the amount that could have been recovered, had this amortization been pressed, been greater or less than the amount of credit that the company received as a result of the deduction on the depletion of leaseholds?

Mr. GREENIDGE. To be conservative about it, I had better say it would have been approximately the same, because the leasehold depletion was $1,690,000, and this is $1,198,000.

Senator COUZENS. That only covers one year of the depletion.

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. There were two years allowed on depletion.

Mr. GREENIDGE. Oh, yes, sir; and there are subsequent years also.

Senator COUZENS. So that it could not be said that the failure to press the amortization charge offset the depletion credit?

Mr. GREENIDGE. I could not say entirely or more or less.

Senator COUZENS. I mean for over the two-year period, the two-year period of allowance, your depletion credit on leaseholds was much more than the amortization claim for 1916.

Mr. GREENIDGE. Yes.

Doctor ADAMS. For what years would the amortization credit be applied?

Mr. GREENIDGE. In 1918.

Doctor ADAMS. In 1918?

Mr. GREENIDGE. And subsequent years.

Senator COUZENS. Is there anything else, Mr. Hartson, that we asked you to get?

Mr. HARTSON. I do not recollect, Senator, that you asked for anything further about the Gulf matter. I have here a list of those things about which you did inquire.

Senator COUZENS. Is there anything else that this witness can testify to?

Mr. HARTSON. I think not.

Mr. GREENIDGE. Senator King asked that a problem be worked out for him, and it is ready if the committee wishes it, or shall we wait until the Senator is present?

The CHAIRMAN. What was the problem?

Mr. GREENIDGE. On a well that came in with 5,000 barrels per day, he wanted to know what the taxes would be on it.

The CHAIRMAN. I think you might put that in the record, because the Senator might not be here to-day.

Mr. GREENIDGE. All right, sir.

Here is another curve, Senators. You see how much more rapidly the fall off of that well is. That is the average curve of the Santa Fe Springs, Calif. You see how very rapid the fall off is.

Senator King asked that the initial production of the well be taken at 5,000 barrels, and its first year's production would be 465,000 barrels, approximately—not in excess of a million barrels, as the Senator thought. It has been worked out allowing $40,000 for drilling ex-

pense and a thousand dollars as the cost of the property. It shows the tax on that well, if the taxpayer had no other income, would have been $25,744, or he would have paid approximately 30.8 per cent of his net income in tax.

He also asked that it be computed without depletion, which we have done, and it shows that his tax would have been 45 per cent of the net income, instead of 30.8 per cent.

These papers will go into the record, as I understand it.

(The statement showing the computation above referred to is as follows:)

Computation of tax without benefit of depletion and assuming there is no other income:

Gross income	$203,437.50
Drilling and expense	40,000.00
Taxable net income	163,437.50
Less exemption	2,000.00
Amount subject to normal tax:	
At 6 per cent	161,437.50
At 12 per cent	4,000.00
	157,437.50
Tax for 1918	240.00
	18,892.50
Surtax on $161,437.50	55,915.00
Total tax	75,047.50

Percentage of net income paid in tax, 45.9.

Senator COUZENS. I hardly think that that quite answers the question that Senator King had in mind, because you point out that, under a certain statement of fact, the percentage of income he would have paid would have been some 30 per cent and a fraction.

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. And then, under another statement of fact, it would have been 45 per cent?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. But that statement does not show the relation of the income to the investment. In other words, he complained, as I recall it, that these depletion charges and credits are so large that they leave an enormous profit as related to the investment.

Mr. GREENIDGE. Well, we included the depletion charge, Senator, in the first computation. Perhaps I do not understand your question, Senator.

Senator COUZENS. I mean, in the case that Senator King referred to, the hypothetical case——

Mr. GREENIDGE. Yes.

Senator COUZENS. Where there was $41,000 invested——

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. And this discovery was made, as you have stated, of 5,000 barrels per day——

Mr. GREENIDGE. Yes, sir; 5,000 barrels per day.

Senator COUZENS. How much would his income have been that year?

Mr. GREENIDGE. $203,437.50.

Senator COUZENS. So that in the first year he would have had a 500 per cent return on his investment of some $41,000.

Mr. GREENIDGE. Approximately; yes.

Senator COUZENS. And in spite of that 500 per cent return on his investment, he received a depletion credit of how much?

Mr. GREENIDGE. $79,910.

Senator COUZENS. In other words, his depletion credit was twice the amount of his investment?

Mr. GREENIDGE. Approximately; yes, sir.

Senator COUZENS. That is a judtifiable criticism, I think, of the whole system of depletion. There is an exact and definite case.

Doctor ADAMS. You mean the discovery depletion?

The CHAIRMAN. The discovery depletion.

Senator COUZENS. Yes; the discovery depletion.

Mr. GREENIDGE. I am glad you covered them all. Both of these figures are in here, both with and without depletion.

Senator ERNST. How would that work out in the course of 10 years?

Mr. GREENIDGE. His production in the second year would be only 150,000 barrels.

Senator ERNST. What about the third year?

Mr. GREENIDGE. It would be 68,000 barrels, and in the fourth year 37,000 barrels, and so on. This was pertty close to a typical well in the Santa Fe Springs field, California. We took their general curve average. Senator King happened to mention that name in his discussion, and of course I thought of it, and I am sure this covers the figures that his line of questioning seemed to bring out.

Senator ERNST. And there are a good many cases of that kind?

Senator COUZENS. Oh, yes; and this is a typical case that Senator King is justifiably complaining of. This whole system of depletion credits on discoveries is ridiculous and absurd.

Mr. GREENIDGE. This also becomes a part of the record.

Doctor ADAMS. Mr. Greenidge, would it be practicable to illustrate the rapid decline of this Gulf Oil Co.'s properties by curves, and comparing them with the general curves for the district?

Mr. GREENIDGE. Yes, sir.

Doctor ADAMS. Do you want that in?

Senator COUZENS. What was that, Doctor Adams?

Doctor ADAMS. I suggested that curves showing the decline of the Gulf Oil Co.'s properties be compared with the average for the same district, to show the more rapid decline of the Gulf Oil Co.'s properties.

Mr. GREENIDGE. Curves are shown in the new oil and gas manual. Curves for all districts are there, published in book form.

Senator COUZENS. I hardly think that is necessary, if it is already available.

Mr. GREENIDGE. Yes; it is obtainable there.

Senator ERNST. Does that also show what the Government gets from each of those each year?

Mr. GREENIDGE. Yes, sir; in taxes.

Doctor ADAMS. I think Mr. Greenidge might be in a position to give you, in reference to the oil industry, the ratios of the tax to the gross income, etc. He might give you general figures, answering the same question to which this particular illustration applied.

The CHAIRMAN. What do you mean by that, Doctor?

Doctor ADAMS. He might be able to show you for particular years what percentage of gross income the oil industry pays in income and excess profits taxes.

The CHAIRMAN. Yes.

Doctor ADAMS. And what the depletion amounts to in reference to it.

Mr. GREENIDGE. I am not sure that I have those figures with me, but we may have.

I think, Senator Couzens, I should mention to you the number of dry holes that are drilled, in comparison to the producing wells. That has no particular bearing on this case, I realize, but I have some figures on that. If you think it would be of any interest to you, I will submit those figures in the various fields.

Senator COUZENS. I did not hear the beginning of your statement.

Mr. GREENIDGE. I have some figures on the number of dry wells, the percentage of dry wells that are drilled in the various fields in the United States. If you think it would be of any interest to you, I will be glad to submit them.

Senator COUZENS. What do you intend to demonstrate by them?

Mr. GREENIDGE. Nothing, other than the fact that although this was a producing well, it would be only one of so many dry wells.

Senator COUZENS. It would only demonstrate the two parallel businesses, where one might succeed and the other might not.

Mr. GREENIDGE. Yes. Senator King asked some questions, and I, of course, prepared these figures.

Senator COUZENS. So far as I am concerned, I am not particularly interested in them. I do not know about the other Senators of the committee.

The CHAIRMAN. I do not think so.

Mr. GREENIDGE. All right, sir. If Senator King wishes it at any time, it is ready for him.

The CHAIRMAN. Yes. If you should put it in the record for him, he would probably not read the record, and in addition he might want to hear it.

Mr. GREENIDGE. Yes.

Doctor ADAMS. May I ask Mr. Greenidge this? It is relevant to one point in his testimony, as to whether the 30-day period within which valuation for discovery wells must be made is such that it is really practicable to get the data to make a sound valuation within that period?

Mr. GREENIDGE. No; it is not. It is absolutely impossible.

Doctor ADAMS. In other words, that feature of the present law is thoroughly impracticable?

Mr. GREENIDGE. Absolutely.

Senator COUZENS. When these valuations are fixed within the time period just referred to by Doctor Adams, is the price of oil for that particular year figured as the basis?

Mr. GREENIDGE. At that date, it is used as the basis.

Senator COUZENS. The date of the discovery?

Mr. GREENIDGE. The date of the discovery; yes, sir.

Senator COUZENS. Then the price of oil may rise or fall, and yet the depletion charge would not be affected?

Mr. GREENIDGE. Yes, sir. It has a sort of balancing effect. If the man who discovers oil at $1 gets a depletion charge of 50 cents, and the oil goes to $3.50, he still gets a depletion charge of 50 cents. If the price of oil is at $3.50 when he discovers it, he gets a depletion unit of $2, and if it goes to $1 he gets that.

Senator COUZENS. In other words, he gets twice as much depletion charge as the oil is worth on the market? Can you not conceive of any better method of arriving at it than in such a ridiculous way as that?

Mr. GREENIDGE. To attempt to use the average price of oil, Senator Couzens, over a period of years, drifts us into a mass of argument with everyone who comes up with a tax case, as to the price that you may use; and after a great deal of thought and discussion it was decided that the price at date of discovery should be used, although it did injury to some and granted others, perhaps, a little more than they should have. In the long run it balances itself, which is what you would attempt to do by an average price of oil, anyway.

Senator COUZENS. You spoke awhile ago of 90 men called in to arrange the oil regulations. Is that correct?

Mr. GREENIDGE. Yes; but I should have said they were called in for all natural resources, timber, coal, metals—I think for the entire natural resources industries, there were 90, and I am only speaking from hearsay on that, but I do know that there were a large number, because I have met 15 or 20 myself who were there.

Senator COUZENS. Were there any recommendations made by that board as to a better method of simplifying the question of depletion?

Mr. GREENIDGE. No, sir; their recommendations were made to initiate, rather than to simplify or to modify. They were here in 1918 or 1919. It was before my time, anyway.

Doctor ADAMS. May I ask Mr. Greenidge another question about prices?

The CHAIRMAN. Yes, Doctor.

Doctor ADAMS. In making valuation for discovery depletion, you use the price of oil prevailing in that district at the date of discovery?

Mr. GREENIDGE. Yes, sir.

Doctor ADAMS. Or within 30 days thereafter, which, or both?

Mr. GREENIDGE. We generally take it at the date of discovery of the oil.

Doctor ADAMS. Has that same thing been done with respect to the March 1, 1913, valuations?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. You have not been able to determine whether or not any other companies were required to fix it at the 5 per cent basis, have you?

Mr. GREENIDGE. No, sir. I did state, however, that some companies did not use any.

Senator COUZENS. Why was that?

Mr. GREENIDGE. Because their valuations, as set up, disregarding any discount factor, were so reasonable, or so nearly within the limits of reasonableness that a discount factor became an unimportant phase. In fact, as I testified at a previous hearing, I personally would not introduce the discount factor. I think, as a matter

of act, the present worth applies more closely to banking and tangible convertible collateral, than it does to an intangible thing like oil. However, that is personal opinion.

Senator COUZENS. Have you had any case paralleling the case of the Gulf Oil Corporation depletion, in regard to the depletion of coal or other minerals?

Mr. GREENIDGE. No, sir. You see, coal is more easily measurable, and values of coal lands are much more easily determinable, because they are bought and sold by the acre, and records are easily accessible in the courthouses, or from the taxpayer's records.

Senator COUZENS. When a coal company leases the property and takes a royalty of 10 cents a ton or 50 cents a ton, or whatever the case might be, do you divide the depletion credits between the lessor and the lessee in that case?

Mr. GREENIDGE. Oh, yes. The operator gets a certain proportion for depletion, and the lessor also.

Senator COUZENS. Do you have the basis of the cost per ton?

Mr. GREENIDGE. Yes.

Senator COUZENS. At the time it was sold?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. And you fix the cost of the coal at the time of the discovery, just the same as you do at the date of the discovery of oil?

Mr. GREENIDGE. Pardon me, but discovery is not allowable, and has never been allowable in coal, because the coal fields have been treated as being known by our geological bulletins or by other publications, such as the Bureau of Mines, so that the discovery factor does not apply to coal.

Senator COUZENS. Does it apply to any other minerals?

Mr. GREENIDGE. Yes, sir; it does to copper, zinc, lead, mercury, etc. It does not, however, apply to timber, which is another natural resource on which depletion is allowed.

Senator COUZENS. Would it apply to iron ore?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. Do you have the same depletion in arriving at depletion charges in those cases as you have in the case of oil?

Mr. GREENIDGE. No, sir; I can not say that we have.

Senator COUZENS. No such controversies ever existed or do now with respect to these minerals as they do with respect to oil?

Mr. GREENIDGE. Not as great controversies, I should say; no.

Senator COUZENS. Have you formulated in your mind any plan of arriving at discovery depletions which might be better enacted into law than the plan which now exists?

Mr. GREENIDGE. I have given a great deal of thought to the subject, and have my mind made up definitely on some of the phases of it, but not on all.

Senator COUZENS. Your office does not agree, does it, with the recommendations that are now before the Finance Committee of the Senate, or perhaps, rather, in the revenue bill sent over from the House?

Mr. GREENIDGE. I could not answer that question yes or no, Senator, because it would be criticizing what a superior officer had done, and I would rather ask to be excused from answering that, if you would permit me.

Senator COUZENS. Well, the inference, of course, that we get from that is that you are not in accord with it.

Mr. GREENIDGE. As I stated before, on the 30-day principle, the valuation at date of discovery or 30 days thereafter——

Senator COUZENS. And you are not all agreed on the blanket allowance of a maximum of 50 per cent return?

Mr. GREENIDGE. I have not been called upon to express an opinion on that by the department.

Senator COUZENS. And you would rather not do it here?

Mr. GREENIDGE. I would prefer that your question be withdrawn, Senator, if you will please do so.

Senator ERNST. Expunge that from the record. You do not think that you men are not allowed to have an opinion on those propositions, do you?

Mr. GREENIDGE. Oh, yes; we are allowed to have them all right.

The CHAIRMAN. And to express them, I mean.

Mr. HARTSON. I am very sure that the Secretary would have no objection to Mr. Greenidge expressing his own opinion.

The CHAIRMAN. Certainly not. Because the Secretary or the bureau formulates the policy that should be followed, that does not mean that you are to have no opinion of your own about the proposition, as to whether it is a right or a wrong policy. Otherwise, we never would be able to get any expert opinion from anybody inside the Treasury, and that is what we are trying to get now.

Mr. GREENIDGE. I have not been instructed along those lines. Remember, I am not objecting to it. I am quite willing to do it, but, as a matter of ethics, I have refrained from answering the question, because this policy has been laid down by a superior officer. However, on the advice of counsel of the department, that I should progress. I will do so without hesitancy.

Senator COUZENS. The point is that the Finance Committee and other members of the Senate are not all going to agree upon the section in the revenue act as it came from the House, in dealing with this matter, and I thought you might have some expert advice to give us as to what others thought than those who were successful in having it put in the act.

Mr. GREENIDGE. Yes, sir. I am at your service, gentlemen, as far as I am permitted to be. I am very anxious to do everything I can, because I believe in simplification and practicability, if possible.

Senator COUZENS. Tell us how you would proceed to deal with this thing, if you were the chief?

Mr. GREENIDGE. First of all, I would eliminate the 30-day clause, the date of discovery, or within 30 days thereafter. The minimum that I should possibly take would be 72 days, and preferably a year. I mention 72 days because if a man brought in a well at the end of a year he would have January, February, and half of March to figure his possible output of the well before the filing of his tax return for that year. That is why I place that limit, but that is the minimum that should be considered.

Doctor ADAMS. May I ask Mr. Greenidge this question, because I am interested in this: With respect to the division of the discovery depletion between the lessor and the lessee, Mr. Greenidge, do you think that a lessor, under ordinary circumstances, has any real

claim for a part of this discovery depreciation, or, from the standpoint of equity, does it actually belong to the lessee, the real discoverer?

Mr. GREENIDGE. Yes. My ideas on that, Doctor Adams, are very decided.

Doctor ADAMS. In other words, that the lessee is really entitled to it, and the lessor, being the passive agent, is not entitled to it; is that correct?

Mr. GREENIDGE. Yes; I fully agree with you. The lessee is entitled to practically all of it, in my opinion.

Doctor ADAMS. Will you call the attention of the committee to the very difficult problem that exists in the present statute? For instance, the statute now gives this discovery depletion only in case the taxpayer is the discoverer, has made the discovery, and yet, for reasons, the department divides the discovery depreciation between the lessor and lessee.

Senator COUZENS. The statute requires it.

Mr. GREENIDGE. Yes.

Doctor ADAMS. Well, the statute does both things. The statute says that discovery depletion shall be granted only in case the discovery has been made by the taxpayer. Apparently, therefore, the benefit of discovery depletion should go only to the discoverer, and yet there is another provision of the statute, as you say, which says that this allowance shall be equitably divided between the lessor and the lessee. My question is, is it possible to amend the statute in a way that would simplify that situation?

Mr. GREENIDGE. I am quite sure that that should be done, in my opinion. Let us take an instance like this: Oil is discovered, and the market price of it is $1. The lessee gets by with a depletion unit of 25 cents, and it is quite possible for the lessor to get by with a depletion unit of 75 cents. The lessor has not expended one penny in money or one hour in energy to discover it. Nevertheless, he is allowed it in a greater amount. Of course, he does not get as great an amount of income, but he takes no risk; that is, the lessor takes no risk.

Doctor ADAMS. Mr. Greenidge, with respect to that 30-day provision and with respect to the division between lessor and lessee, does the revenue bill as it passed the House make any change in the existing law?

Mr. GREENIDGE. I think not. From what I have seen of it, I should say no.

Doctor ADAMS. One further question. Is it not highly desirable, from a practical standpoint, to avoid valuation, if possible, or to the extent possible?

Mr. GREENIDGE. No; not to the extent possible, but to the extent practicable. "Possible" is a little too great a limit to introduce there.

Doctor ADAMS. Other things being equal, then, any depletion provision which satisfied the requirements of equity and sound policy and avoided valuation would be far superior to one that included the necessity for valuation, would it not?

Mr. GREENIDGE. I should say so, sir. Wherever you can avoid taking another step in a procedure necessary for tax collection, I should say it would be a good thing.

Doctor ADAMS. From your investigations of the subject are you convinced that a depletion discovery based on gross income, thus avoiding the necessity for a valuation, could be devised which would do everything that the present statutory provisions do?

Mr. GREENIDGE. It has been along those lines that I have been thinking for a long time and have not had time to get enough figures together on that subject to answer it directly yes or no, but it is my opinion that that is a proper line to pursue.

Doctor ADAMS. The present statutory provision for discovery depletion permits a discovery to be made and the benefit of this discovery valuation to be taken by the man who drills a well, even 100 yards from another well, provided the field was not proven when he bought, does it not?

Mr. GREENIDGE. It does.

Doctor ADAMS. In short, offsetting wells are treated, in many instances as discovery wells, are they not?

Mr. GREENIDGE. They have to be under the statute.

Doctor ADAMS. Is that regarded by the experts on this subject as a fair and reasonable carrying out of the intent of the statute—and, by the way, let me say that, so far as I know, you are interpreting the statute correctly.

Mr. GREENIDGE. Yes.

Doctor ADAMS. But it is a question of whether the main purpose of the statute at that point is logically carried out.

Mr. GREENIDGE. That is the place where the discovery clause of the revenue act is abused; that is, in my opinion.

Senator COUZENS. Mr. Hartson, who is here, knows most about the Gulf Oil Corporation case?

Mr. HARTSON. Do you mean the auditors who have actually been working on the figures, or the history of the case?

Senator COUZENS. Yes; the auditor who has been over the figures.

Mr. HARTSON. Mr. Mattson.

Senator COUZENS. If you are through with Mr. Greenidge, I would like to have Mr. Mattson called to the stand.

Mr. NASH. I would like to submit an exhibit here, before Mr. Greenidge leaves the stand, which shows the amount of tax paid by the Gulf Oil Corporation, with the depletion deduction, and computed without the depletion deduction. For 1916 it makes a difference in the tax of about $32,000, and for 1917 it makes a difference in the tax of $817,000, or a total of $849,000.

I want to ask Mr. Greenidge again if, in his opinion, had that amortization claim been pressed it would have resulted in a refund of more than $849,000?

Senator COUZENS. I do not think that matter is relevant. You are bringing in something entirely outside the question. The question is not what might have happened. The question is not what was waived to get under the gateway before Mr. Mellon came in, but what was allowed and what actually happened.

Senator ERNST. Senator Couzens, I would like to know, because a good deal has been said about the Gulf Oil Co. here, and I think it shows that the Gulf Oil Co. has acted in a rather fine way, rather than in a way which would make it open to any sort of attack. There was a claim they could have pressed, and I would like to know just the answer to this question.

Senator COUZENS. I want to say right here, Mr. Senator, that no one on this committee has made any charges against the Gulf Oil Corporation.

Senator ERNST. They were being made on the floor of the Senate to-day.

Senator COUZENS. That has nothing to do with the proceedings of this committee.

Senator ERNST. Yes; because every time the Gulf Oil Corporation has been mentioned you have asked questions about it.

Senator COUZENS. I want to say right here that I shall object to this, because it is not a part of the record.

Senator ERNST. You can object to it, but I have a right to have it in, and I am going to ask the question.

Senator COUZENS. You may have it in, but I am going to object to it, because it is not relevant to this case.

Senator ERNST. You are undoubtedly right in making your objection, but I want the question answered.

Senator COUZENS. But it can not be answered because they have not the figures, and I object to the answer, because he has not the figures.

Senator ERNST. Have you not the figures here?

Mr. GREENIDGE. Not exact figures to show what the offset would be, but if it does not equal that, it very nearly does.

Senator ERNST. Then, give it as nearly approximate as you can.

Mr. GREENIDGE. That additional deduction would have thrown it in the 80 per cent bracket, which would be approximately $960,000. I am giving those figures in round numbers, Senator.

Senator COUZENS. Less tax, you mean?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. That would have been paid?

Mr. GREENIDGE. Yes; less tax, that would have been paid.

Mr. NASH. The point to bring out is that the amountr ecoverable, or that could have been recovered by pressing that amortization claim, would have been greater than the amount by which the tax was decreased for 1916 and 1917 as a result of the use as a deduction the depletion of leaseholds.

Mr. GREENIDGE. Yes: approximately.

Senator COUZENS. I want to point out, of course, that we have no evidence that the amortization claim was justified, and no report has been made that it would have been allowed had it been pushed. I want to say further that this information is not relevant to the question of depletion of oil wells. There is a great difference between the depletion of oil wells, and they are not comparable at all.

Senator ERNST. But still that shows the spirit of the Gulf Oil Co. to have everything cleaned up before Mr. Mellon came in. There has been so much talk about him, and I am very glad to have that in this record.

Senator COUZENS. The Gulf Oil Corporation is not under investigation. The Bureau of Internal Revenue is under investigation.

Senator ERNST. The Gulf Oil Corporation is not under investigation, but, at the same time, it is made to look as though the company were trying to get the best of the Government.

Senator COUZENS. This happened during the previous administration, and no charge has been made against the Gulf Oil Corpo-

ration. The whole question is as to why the bureau might allow depletion credit in certain cases and not in other cases.

Senator ERNST. Yes; but every time Secretary Mellon's name is mentioned there is a very keen desire to find out all about it.

Senator COUZENS. I do not know whether you were here or not when Mr. Mellon volunterred this information. Nobody asked for it.

Senator ERNST. But when we can find out any fact which shows that the company in which he was interested has acted in any way in an effort to defraud the Government, I want that also shown.

Senator COUZENS. You are assuming, then, that they attempted to defraud the Government?

Senator ERNST. No; I think I have heard enough said about that company to know that it has not many friends where it ought to have them.

Senator COUZENS. Well, I am glad to see that you are among the friends of the interests.

Senator ERNST. I certainly am.

Mr. GREENIDGE. Before leaving the stand, if I may be permitted to state it, there were two other large allowances made for depletion on lessee value prior to the promulgation of Treasury Decision 3386. In one instance it was close to $2,000,000 to one concern.

The CHAIRMAN. Which concern is that?

Mr. GREENIDGE. I do not think, Senator, that I properly——

The CHAIRMAN. All right.

Senator COUZENS. I do not think that kind of evidence, Mr. Chairman, has anything to do with the case. We can not try this case on that kind of evidence, because we have no way to prove it. They are reading from the record figures that have nothing to do with the case at all. They are being put into the case, and we can not find anything about them, and they do not offer any testimony about them.

The CHAIRMAN. I think the mere statement that some other company was treated in the same way would not be applicable here.

Senator ERNST. I do not think that that does the slightest bit of harm, Mr. Chairman.

The CHAIRMAN. We are talking about oil companies, and unless it was to make a comparison of this oil company with other oil companies, it would not be particularly advantageous, but if it be with regard to any oil company, I would have no objection to his making the statement.

Mr. GREENIDGE. And the other one thing that I think I should call to the attention of the committee before I am excused from the stand is the fact that during the past year the average production of all the oil wells in the United States was 5.7 barrels per well per day. Senator King asked a question that led up to that request.

Senator ERNST. I know some wells that have brought down that average.

Doctor ADAMS. The witness has given the names of about twenty companies that have received this lessee depletion. He now says that he has the names of two other companies. Does the committee want the names of those two other companies?

Mr. GREENIDGE. That was omitted.

The CHAIRMAN. Yes. What are they?

Mr. GREENIDGE. The other companies are the Southern Pacific Oil Co. of California——

The CHAIRMAN. Is that an oil company?

Mr. GREENIDGE. Yes; and the Associated Oil Co. Neither of those cases was closed, although the allowance was made prior to the promulgation of the Treasury decision.

Senator COUZENS. What year did that accrue?

Mr. GREENIDGE. In 1916 or 1917. I have those figures, 19 per cent dry holes.

The CHAIRMAN. Of all of the wells drilled 19 per cent were dry holes?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. Covering what period of time?

Mr. GREENIDGE. Ten years, I am told.

The CHAIRMAN. Do you know how many wells have been drilled in the United States in 10 years?

Mr. GREENIDGE. Yes.

The CHAIRMAN. How many?

Mr. GREENIDGE. I can not tell you offhand.

The CHAIRMAN. Have you a record of all of them?

Mr. GREENIDGE. Oh, yes—240,589.

Senator ERNST. For how long a period does that cover?

Mr. GREENIDGE. From 1910 to 1920.

The CHAIRMAN. Nineteen per cent dry?

Mr. GREENIDGE. Yes, sir.

The CHAIRMAN. And those wells are producing an average of 5.7 barrels a day?

Mr. GREENIDGE. An average of 5.7 barrels per day. That has been increased very materially through flush production of the California field and the Powell field of Texas. In the years prior thereto it probably ran down below 4 per cent. I know it ran below 4 per cent. I will submit these statements for the record at this point.

(The statements referred to are as follows:)

Estimated ultimate recovery, 500,000 barrels oil.

Market price of oil at date of estimate		$1.25
Drilling, pumping, overhead, and all other cost		.25
Net value of oil		1.00

Present worth computed at 5 per cent compound discount for deferred receipts.

First year's production,	240,000 barrels × $1 × $0.9524	$228,576
Second year's production,	120,000 barrels × $1 × $0.9070	108,840
Third year's production,	60,000 barrels × $1 × $0.8638	51,828
Fourth year's production,	36,000 barrels × $1 × $0.8227	29,617
Fifth year's production,	20,000 barrels × $1 × $0.7835	15,670
Sixth year's production,	12,000 barrels × $1 × $0.7462	8,954
Seventh year's production,	6,000 barrels × $1 × $0.7107	4,264
Eighth year's production,	3,000 barrels × $1 × $0.6768	2,030
Ninth year's production,	2,000 barrels × $1 × $0.6446	1,289
Tenth year's production,	1,000 barrels × $1 × $0.6139	614
	500,000	[1] 451,682

Composite discount factor, 9.66 per cent.

[1] Present worth of 500,000 barrels at date of estimate.

Present worth of same number of barrels of oil of same net value per barrel computed at 10 per cent compound discount for deferred receipts:

First year's production,	240, 000 barrels × $1 × $0.9091	$218, 184
Second year's production,	120, 000 barrels × $1 × $0.8264	99, 168
Third year's production,	60, 000 barrels × $1 × $0.7513	45, 078
Fourth year's production,	36, 000 barrels × $1 × $0.6830	24, 588
Fifth year's production,	20, 000 barrels × $1 × $0.6209	12, 418
Sixth year's production,	12, 000 barrels × $1 × $0.5645	6, 774
Seventh year's production,	6, 000 barrels × $1 × $0.5132	3 079
Eighth year's production,	3, 000 barrels × $1 × $0.4665	1, 400
Ninth year's production,	2, 000 barrels × $1 × $0.4241	848
Tenth year's production,	1, 000 barrels × $1 × $0.3855	386
	500, 000	[1] 411, 919

Composite factor, 17.6 per cent.

	Per barrel.
Estimated ultimate recovery, 1,000,000 barrels oil.	
Market price of oil at date of estimate	$1. 25
Drilling, pumping, overhead, and all other costs	. 25
Net value of oil	1. 00

Present worth computed at 5 per cent compound discount for deferred receipts:

First year's production	480, 000 barrels × $1 × $0.9524	$457, 152
Second year's production	240, 000 barrels × $1 × $0.9070	217, 680
Third year's production	120, 000 barrels × $1 × $0.8638	103, 656
Fourth year's production	72, 000 barrels × $1 × $0.8227	59, 234
Fifth year's production	40, 000 barrels × $1 × $0.7835	31, 340
Sixth year's production	24, 000 barrels × $1 × $0.7462	17, 909
Seventh year's production	12, 000 barrels × $1 × $0.7107	8, 528
Eighth year's production	6, 000 barrels × $1 × $0.6768	4, 061
Ninth year's production	4, 000 barrels × $1 × $0.6446	2, 578
Tenth year's production	2, 000 barrels × $1 × $0.6139	1, 228
	1, 000, 000	[2] 903, 366

Composite factor (discount), 9.66 per cent.

Present worth of same number of barrels of oil of same net value per barrels computed at 10 per cent compound discount for deferred receipts.

First year's production	480,000 barrels × $1 × $0.9091	$436, 368
Second year's production	240,000 barrels × $1 × $0.8264	198, 336
Third year's production	120,000 barrels × $1 × $0.7513	90, 156
Fourth year's production	72,000 barrels × $1 × $0.6830	49, 176
Fifth year's production	40,000 barrels × $1 × $0.6209	24, 836
Sixth year's production	24,000 barrels × $1 × $0.5645	13, 548
Seventh year's production	12,000 barrels × $1 × $0.5132	6, 158
Eighth year's production	6,000 barrels × $1 × $0.4665	2, 799
Ninth year's production	4,000 barrels × $1 × $0.4241	1, 696
Tenth year's production	2,000 barrels × $1 × $0.3855	771
	1, 000, 000	[2] 823, 844

Composite discount factor, 17.6 per cent.

Senator COUZENS. I would like to have the auditor that you referred to come on the stand now.

The CHAIRMAN. Just as you want, Senator.

Senator COUZENS. Will you swear the witness?

[1] Present worth of 500,000 barrels at date of estimate.
[2] Present worth of 1,000,000 barrels at date of estimate.

TESTIMONY OF MR. CHARLES J. MATTSON, AUDITOR BUREAU OF INTERNAL REVENUE

(The witness was sworn by the chairman.)

The CHAIRMAN. State your full name for the record.

Mr. MATTSON. Charles J. Mattson.

The CHAIRMAN. You are employed in the Internal Revenue Bureau?

Mr. MATTSON. Yes, sir.

The CHAIRMAN. What branch of the service?

Mr. MATTSON. Auditor.

The CHAIRMAN. How long have you been so employed?

Mr. MATTSON. Since 1919.

The CHAIRMAN. Have you been in the bureau since 1919? Were you in before that time?

Mr. MATTSON. No.

The CHAIRMAN. You have been auditor, then, since you entered the service?

Mr. MATTSON. Yes, sir.

The CHAIRMAN. Very well, Senator Couzens.

Senator COUZENS. Have you audited the accounts of the Gulf Oil Corporation?

Mr. MATTSON. No, sir; I was just called in to prepare this one phase of it.

Mr. HARTSON. Senator, as to auditing the accounts of the Gulf Oil Corporation, I am inclined to believe that there is nobody in the service now who, at that time, in the year 1921, audited those books. I think those auditors have all gone. That is subject to verification, but that is my present understanding, that all of the auditors who checked over the schedules submitted by the taxpayer, have since left the service.

Senator COUZENS. What have you reference to that Mr. Mattson could testify about?

Mr. HARTSON. Mr. Mattson is the auditor who has assisted Mr. Greenidge, in computing these schedules and these depletion allowances which the Senator asked for on Thursday afternoon.

Senator COUZENS. You do not know anything personally about these records that have been presented here as the complete records of the Gulf Oil Corporation, do you?

Mr. MATTSON. I have not verified the records. I merely made the computations as to what would be the result by the allowance and by the disallowance of certain depletion and the percentages.

Senator COUZENS. Have you gone over these records that we have now here in our possession?

Mr. MATTSON. Not all of them. That would be impossible in such a short time. It was just taken from the assessment letter and the income and the taxes shown; applying the depletion to the various operating companies; reducing that back; recomputing the tax; and determining what difference there was in percentage.

Senator COUZENS. In doing so, did you go over the original returns made by the Gulf Oil Corporation and also the amended returns?

Mr. MATTSON. I did not verify any differences between those, because the case was closed on the basis of the amended returns.

Senator COUZENS. I would like to ask Mr. Hartson if there is anybody in the bureau that knows, from an examination of these records, what the difference was in taxes as between the original returns and the amended returns?

Mr. HARTSON. That can very easily be obtained, Senator, and I think it might expedite the production of the information which the Senator wishes, if he would state just exactly what is required, so that, without having a man go through the whole records, with no definite point in mind, we can direct him to some specific line. Now, Mr. Mattson can do that very easily.

Senator COUZENS. I will propound the question and see if you understand it. I would like to have submitted to this committee the difference between the original returns of the Gulf Oil Corporation and the amended returns, with respect to the items of amortization, depletion and other credits, and the difference between the total taxes, by each year, as shown on the original returns and on the amended returns. Do you get that, Mr. Mattson?

Mr. MATTSON. I do. "And other credits" is rather indefinite. That about covers the whole question. It would mean a complete reaudit.

Senator COUZENS. Other relevant credits. What other credits are there that might be taken than those I have enumerated?

Mr. MATTSON. There might be any number of adjustments in the audit of the books that would have no reference whatever to depletion.

Senator COUZENS. Oh, I understand that. We are not only checking the question of depletion. That question of depletion was an after thought. It was a matter of development. When the case was brought before the committee it was on the question of a difference in returns as originally made and the amended returns, which brought a refund of $3,600,000. Is not that correct?

Mr. HARTSON. As the Senator will recollect, Mr. Ernst testified that it was brought about by the allowance in the years 1918 and 1919, pursuant to the law on this discovery depletion, and which had not been sufficiently taken care of by the taxpayer at the time he made his original return.

Senator COUZENS. Well, if you will point that out, that will cover it, as far as I am concerned.

Mr. HARTSON. The Senator will recollect, too, Mr. Ernst's testimony in regard to the practice of the company, the Gulf Oil Corporation, apparently was, and the only fault was that in keeping their books, as well as in making their return, there was a single account, against which was charged in prosperous years these allowances for depreciation and depletion, and I think Mr. Ernst put also amortization in that. It was a sort of arbitrary charge-off, according to the conservative manner in which the company was managed at that time, and we had to go back and reconstruct the books, open new accounts, and get basic values as of the date of organization on March 1 of the company.

Senator COUZENS. I recall Mr. Ernst's testimony to that effect.

Mr. HARTSON. So it is in the light of that that this evidence will have to be produced. The original returns were prepared on that basis.

Senator COUZENS. I do not want to ask Mr. Mattson any further questions.

The CHAIRMAN. Do you want to have this incorporated in the record, as best it can be?

Senator COUZENS. I think so.

The CHAIRMAN. Do you want to offer any supplemental remarks concerning it?

Mr. MATTSON. I have nothing to offer. The statement speaks for itself, unless there are some questions about it.

The CHAIRMAN. Do you want to ask him any questions, Doctor?

Doctor ADAMS. I just want to ask him in regard to one figure. I think that is the 1916 tax, and you had better put it in.

Mr. MATTSON. Yes, sir; that is the 1916 tax.

(The statement referred to is as follows:)

	Year	Gross income	Net income with all depletion deductions	Net income with Mar. 1, 1913, deduction for 1916-17 and excluding discovery depletion 1918-19	Tax column 2	Tax column 3	Percentage column 4 to column 2	Percentage column 5 to column 3
Gulf Oil Corporation	1916	1,492,361.06	1,135,905.92	1,135,905.92	22,718.12	22,718.12		
	1917	4,916,225.59	4,491,094.59	4,491,094.59	749,820.46	917,814.28	16.69+	20.43+
	1918	1,209,519.43	503,676.68	503,676.68	446,904.85		88.73	
	1919	16,216,523.70	580,935.73	580,935.73	25,138.10		4.32	
Gulf Pipe Line Co	1916	4,106,966.49	2,757,041.80	2,757,041.80	55,140.84	55,140.84		
	1917	40,885,771.47	1,615,921.04	1,615,921.04	321,500.78	381,932.76	13.71+	23.64
	1918	34,816,789.65	1,441,413.29	1,441,413.29	160,763.98		11.15	
	1919	39,081,755.58	1,362,941.20	1,362,941.20	31,130.97		2.28	
Gulf Refining Co	1916	7,829,004.96	923,898.47	923,898.47	18,477.97	18,477.97		
	1917	71,766,951.78	1,295,642.10	1,295,642.10	257,906.41	306,395.04	19.90+	23.65
	1918	69,280,242.16	4,255,013.76	4,255,013.76	128,991.69		3.03	
	1919	79,760,596.75	4,394,857.34	4,394,857.34	24,978.46		5.68	
Gulf Production Co	1916	631,995.97	(466,884.50)	(300,658.62)	None.	None.		
	1917	6,710,967.73	1,414,245.48	1,556,347.04	261,498.14	342,946.92	19.90+	22.04
	1918	6,043,364.61	359,946.75	2,513,479.11	140,787.39		39.11	
	1919	8,120,787.01	(5,128,794.20)	1,843,843.02	27,262.62			
Gulf Refining Co. of Louisiana	1916	5,642,244.53	2,246,737.61	2,968,356.52	44,934.75	59,367.13		
	1917	15,140,659.08	3,192,109.40	4,047,858.76	635,302.91	806,081.53	19.90+	19.91
	1918	13,784,863.07	2,355,532.32	3,307,169.01	317,722.90		1.35	
	1919	13,637,395.70	5,517,262.86	1,615,557.24	61,525.11		11.89	
Gulf Pipe Line Co. of Oklahoma	1916	5,273,271.43	3,968,431.10	3,968,431.10	79,368.62	70,368.62		
	1917	19,529,057.02	2,893,432.28	2,893,432.28	575,661.98	683,867.44	19.89+	23.64
	1918	8,136,273.94	2,368,540.72	2,368,540.72	287,853.14		12.15	
	1919	12,246,165.17	351,891.02	351,891.02	55,741.01		15.84	
Gypsy Oil Co	1916	9,432,301.71	3,837,716.57	4,553,274.93	76,754.33	91,065.50		
	1917	11,008,253.03	3,807,359.85	4,346,540.31	757,518.66	932,260.15	19.89	21.45
	1918	12,281,434.82	(1,090,086.27)	6,039,226.32	378,794.19			
	1919	10,611,002.11	2,239,505.71	4,347,692.17	73,351.20		3.28	
Mexican Gulf Oil Co	1916	549,918.22	(155,630.37)	(155,630.37)	None.	None.		
	1917	954,632.59	(653,001.20)	(653,001.20)	None.	None.		
	1918	1,977,226.08	(584,089.65)	(474,881.97)	None.			
	1919	5,371,374.62	(46,178.80)	157,538.76	None.			
Gulf Cooperage Co	1916	38,992.25	23,327.75	23,327.75	466.56	466.56		
	1917	1,316,124.33	96,566.02	96,566.02	19,346.41	22,993.68	20.03	23.81
	1918	186,843.87	115,675.89	115,675.89	9,702.91		8.39	
	1919	149,482.49	82,233.46	82,233.46	1,678.91		2.04	
Gulf Commissary Co	1916	61,765.94	13,034.40	13,034.40	260.69			
	1917	461,752.25	21,629.91	21,629.91	4,220.88	5,007.56	19.51	23.15
	1918	83,806.54	17,904.06	17,904.06	2,092.79		11.69	
	1919	110,093.22	36,551.79	36,551.79	405.26		1.11	
Indiana Oil & Gas Co	1916	342,633.88	124,307.21	270,978.77	2,486.14	5,419.38		
	1917	488,763.27	242,714.50	396,396.09	48,311.12	66,614.71	19.90	16.80

Gulf Oil Co	1918	469,442.98	282,564.31	282,564.31	24,162.16		8.55	
	1919	442,132.53	259,787.44	259,787.44	4,878.86		1.88	
	1916	115,073.39	91,821.45	91,821.45	1,836.43	1,836.43		
	1917	106,396.70	47,662.18	47,662.18	9,503.09	11,291.01	19.94	
	1918	None.	(.66)	(.66)	4,756.33			
					921.03			
South American Gulf Oil Co	1916	None.	(23,642.49)	(23,642.49)	None.	None.		
	1917	None.	(35,511.35)	(35,511.35)	None.	None.		
	1918	None.	(22,062.41)	(22,062.41)	None.			
	1919	3.33	(90,089.02)	(90,089.02)	None.			
Eastern Gulf Oil Co	1917	176.92	(34,644.88)	(34,644.88)	None.	None.		
	1918	5,566.19	(96,480.07)	(40,903.01)	None.			
	1919	308,249.02	52,110.85	264,505.18	None.			
Totals	1917	173,285,731.76	18,395,219.92	20,085,932.89				
	1918	148,275,373.34	9,905,548.72	20,306,815.10				
	1919	186,055,561.23	4,613,015.38	15,208,245.33				
Intercompany eliminations	1917	None.	2,899,437.66	2,899,437.66				
	1918	96,711,950.83	969,773.56	969,773.56				
	1919	115,110,825.74	1,394,197.34	1,394,197.34				
Consolidated	1916				302,444.45	334,121.24		
	1917	173,285,731.76	15,495,782.26	17,186,495.23	3,660,590.84	4,477,206.18	23.62+	26.05+
	1918	51,563,422.51	8,935,775.16	19,337,041.54	1,902,532.33	8,777,684.52	21.29	45.39
	1919	70,944,735.49	3,218,818.04	13,814,047.99	307,011.53	2,579,127.14	9.54	18.67

Mr. HARTSON. You asked for the returns of the Gulf Oil Corporation for subsequent years, 1920, 1921, and 1922. Those are here if the Senator wishes them now.

Senator COUZENS. Were they accepted in the original form, or were they amended?

Mr. HARTSON. I think they are now in process of auditing. I do not know that there have been any amended returns for them.

Senator COUZENS. You might show us what you have here.

Mr. HARTSON. Yes; they are the returns for 1920, 1921, and 1922. The 1923 return, of course, is not available as yet.

Senator COUZENS. I would like to ask Mr. Hartson a question or two.

STATEMENT OF MR. N. T. HARTSON, SOLICITOR INTERNAL REVENUE BUREAU—Resumed

Senator COUZENS. In this letter, Mr. Hartson, that you presented to the committee, from the Secretary of the Treasury, dated March 25, the Secretary wrote, as I understand the letter, to the effect that it was from newspaper stories and not from anything that was requested by this committee. Is that your understanding of it?

Mr. HARTSON. I was not present at the time that that was prepared, and never heard of the letter, nor knew of its contents, until it was read here to the committee, Senator Couzens. You will recollect that the day before that letter was produced, I told the committee that I thought the Secretary would have no objection at all to presenting the records in the Gulf Oil case, and upon returning to the Treasury I so informed the Secretary that I had told the committee to that effect.

The next day that letter came out. Now, I do not know what the letter does say in regard to newspaper reports.

Senator COUZENS. I will just read it to you.

The CHAIRMAN. Was that letter addressed to you, Senator?

Senator COUZENS. No; it was addressed to you. It was turned in here at the hearing.

The CHAIRMAN. Yes; that is right. I remember it now. Was it incorporated in the record?

Senator COUZENS. Yes.

In the hearing before your committee yesterday what purported to be a copy of a memorandum delivered by an ex-employee to a member of your committee was introduced and has been made the basis for headlines in the newspapers which might lead the public to believe I had sought to influence the Bureau of Internal Revenue in its consideration of the tax liability of certain companies in which I am interested as a stockholder. As I have already stated, I have never interfered in any way with the Bureau of Internal Revenue in any tax matter, least of all would I do so in cases in which it might be charged that I was personally concerned. I feel, however, that it is due to me and to the companies involved that your committee make an immediate investigation in order that you may throughly satisfy yourself and the public whether or not these companies have received any favors from the Government.

You will see that he refers to the companies in which he is a stockholder.

Then the letter goes on and says:

Three companies which have been mentioned are the Gulf Refining Co. and its subsidiaries, the Standard Steel Car Co., and the Aluminum Co. of America.

Each of these companies has advised the Commissioner of Internal Revenue that it waives its right to privacy under the statute.

At that point, I would like to ask you if you have any copy of the waiver of that notice?

Mr. HARTSON. I have none. I am informed by Mr. Greenidge that these companies have submitted proper waivers, executed by their duly empowered officers. I did not know that personally.

Senator COUZENS. Do you know of any other companies in which the Secretary is interested besides those three?

Mr. HARTSON. I do not know the Secretary's companies.

Senator COUZENS. In view of the suggestion of the Secretary that the companies that he is interested in be investigated, would you mind asking the Secretary to submit a list of all the corporations and companies that he is interested in?

Mr. HARTSON. I will be very glad to.

Senator COUZENS. I think that will probably be more convenient than to subpœna the Secretary to produce his records.

Mr. HARTSON. Yes, sir; I shall be glad to do that.

Senator COUZENS. I would like to have you bring down here a list of the companies, including the one that is in trust in the Union Trust Co. of Pittsburgh, namely, the Overholt Distillery Co.

Senator ERNST. Mr. Senator, in view of your remarks a little while ago, what will the summoning of those companies have to do with getting at any constructive methods to better conduct this bureau? Why take his companies rather than some other companies?

Senator COUZENS. The Secretary suggested it.

Senator ERNST. I know, but you seem eager to have those companies. Why not suggest some others?

Senator COUZENS. I will be delighted to do so, if they will waive their statutory rights.

Mr. NASH. Mr. Chairman, I have some replies from companies whose names have been mentioned by some of the witnesses, who have indicated that they will waive their rights also.

Senator COUZENS. Will you enumerate those companies to the committee, please.

Senator ERNST. The point I am trying to get at is this: Can you find out how these results are arrived at from figures, without naming the companies, in order that we may find out just what you are endeavoring to ascertain? Why is it necessary to go into the particulars of each of these companies when these gentlemen have all of the books and figures, and can tell you just the manner in which they arrived at their results? Why should we hunt up some particular company, rather than take these facts that these gentlemen can give us and then form our opinions from them?

Senator COUZENS. But we will have no concrete case.

Senator ERNST. They have given you all of the concrete cases you want, without the names of the companies.

Senator COUZENS. Well, we will have no opportunity of checking the figures to see how it is done, if you do not have concrete cases. We will only have hypothetical cases then.

Senator ERNST. No; they can give you the cases based on the actual facts and tell you exactly how they arrived at the facts, without giving the name of the company

Senator COUZENS. I have no objection to that. I am investigating the companies which the Secretary requested us to investigate.

Senator ERNST. I think that would make it all right. It would not look as if we were after Mr. Mellon and his companies. Then our work would look as if it was really constructive, but now it looks as if we were after the Secretary of the Treasury.

Mr. HARTSON. Mr. Nash, have you those letters?

Mr. NASH (handing letters to Mr. Hartson). Yes.

Mr. HARTSON. These, Senator, are photostatic copies of letters that have been received by the commissioner.

Senator COUZENS. Will you read them into the record, please?

Mr. HARTSON. The first one is from the Berwind-White Coal Mining Co., Philadelphia, Pa., and is addressed to Hon. D. H. Blair, Commissioner of Internal Revenue, Treasury Department, Washington, D. C., dated March 26, 1924:

MY DEAR SIR: Answering your courteous inquiry of March 24, we not only have no objection to your disclosing to the investigating committee of the Senate any information which it may require in connection with the matter to which you have referred, but we shall be pleased to have you submit also to the committee any other data affecting our relations with your bureau which may seem to you pertinent to pending issues.

The adjustment of which criticism has been offered was accomplished by the writer after negotiations extending over a period of practically two years, during which he rarely came twice in contact with the same representative of the department. You may rest assured—if assurance be required—that the results so accomplished were consistent with the laws of Congress and with the regulations promulgated by the department in pursuance thereof, and were favorable to the Government rather than to ourselves, as the concessions which we were thereby obliged to make were preferable only to the protracted litigation which would have been required to secure to us the full measure of relief to which we felt we were entitled.

We have no desire to augment the volume of testimony now being adduced before the committee; but we are duly mindful of the high principles governing your administration of the bureau, and if you should so desire we shall be pleased to acquaint the committee with the details of the instant case, and to attest to the unimpeachable character of the officials by whom our amortization claim was finally adjusted.

With great respect, we are, very sincerely yours,

THE BERWIND-WHITE COAL MINING CO.,
H. O. MIDDLETON, *Treasurer*.

The committee will recollect that that company was a company referred to by a former employee of the bureau in his testimony, to the effect that the amortization claim in this case was unduly favorable to the company. I think this discharged employee had turned in a report which had not been 100 per cent concurred in by the bureau officials, and he testified that the settlement of this case ought to be the subject of inquiry. This is a waiver of that company of their right of privacy of their returns.

The next letter is from Lee S. Smith & Son Manufacturing Co., dental products, Pittsburgh, U. S. A., dated March 26, 1924, and addressed to Mr. D. H. Blair, Commissioner of Internal Revenue, Washington, D. C.:

DEAR SIR: Referring to your letter of March 24, we grant you our permission to submit any and all papers and data pertaining to our case, should a request be made on you by the investigating committee to do so, as we have absolutely nothing to withhold from the proper authorities.

Respectfully yours,

LEE S. SMITH & SON MANUFACTURING CO.,
CHARLES PETERSON, *Treasurer*.

That is another case similar to the case just referred to, where a former employee of the bureau testified that an amortization claim had been allowed in excess of what properly should have been allowed under the law.

Senator COUZENS. Did the department write to any other concerns whose names were mentioned in the testimony, outside of those two?

Mr. HARTSON. I believe the department wrote to all of those companies that were referred to here in the testimony by those who disagreed with the adjustment made by the department.

Senator COUZENS. And those are the only replies you received?

Mr. HARTSON. So far as I know, these are the only two.

Mr. NASH. Those are the only two that have been received and sent over to my office, Senator.

Senator COUZENS. In other words, there was some bag company, the Standard Oil Co., and a number of others mentioned in the testimony, from which you requested the same waiver?

Mr. HARTSON. We sent out a form letter to all of the companies whose names have been mentioned in the course of the inquiry.

Senator COUZENS. I think that is a very excellent idea.

The CHAIRMAN. How many of them were there?

Mr. HARTSON. There must have been a dozen or some such number as that. I have no definite recollection of it.

Senator COUZENS. Will you furnish the committee a list of those to whom you wrote letters?

Mr. HARTSON. I shall be very glad to.

Mr. GREENIDGE. I think you meant the Standard Steel Car Co. when you said Standard Oil Co., did you not?

Mr. HARTSON. The Standard Oil Co. was referred to by Mr. Rossmoore.

Mr. GREENIDGE. The Standard Steel Car Co. has already waived its right.

Senator COUZENS. Pursuant to Mr. Mellon's letter, I think we ought to have the records of the two companies that he refers to, the Aluminum Co. of America and the Standard Steel Car Co. He specifically referred to those two.

Mr. HARTSON. They are here. We have been bringing them up here every day.

Mr. GREENIDGE. Those particular ones are not here, but they can be brought here.

Mr. HARTSON. They are subject to the committee's wishes. They can be brought.

Mr. NASH. Senator Couzens, may I say that the files in those cases are quite voluminous, and it is quite a task to bring them down and haul them back. If we could get a little advance information as to when these cases are wanted, we could bring them down at that time.

The CHAIRMAN. What advantage is there in the bringing of all of these books here?

Senator COUZENS. I do not think there is any advantage in it.

The CHAIRMAN. No; we will never look into those.

Senator COUZENS. I would like to suggest, in view of the fact that the officials of the bureau have submitted the original returns and the amended returns of the Gulf Oil Corporation, if they were to bring the original returns and the amended returns, with a statement

attached of the credits and allowances, that might answer the purposes of the committee.

The CHAIRMAN. I think so, and it would not be necessary to bring all of these books, because we will never look into them.

Mr. HARTSON. When the Senator speaks of credits and allowances, I assume he has particular reference to allowances for depletion and amortization?

Senator COUZENS. Yes.

Mr. HARTSON. Now, there are a great many others, as Mr. Mattson indicated here. There is the one of depreciation, which the Senator might also wish, and which, on the face of the returns, might appear as a separate item, and it might not, and there are also certain other credits and deductions, for instance, for expenses or for losses or for contributions. There are many of them, and on the face of a return, numbers of them are grouped together.

Senator COUZENS. I think if you bring those down, making a memorandum and attaching it to these returns, showing the credit allowed for those major items, it will be satisfactory.

Mr. HARTSON. Yes.

Senator COUZENS. For example, I think the returns themselves in a good many cases, show the credits for a good many of these things, do they not?

Mr. HARTSON. That is true. Most of these returns of the big companies have schedules attached to them. They all come in many sheets that are attached to the original form return, and those contain itemized statements.

The CHAIRMAN. You can bring the information we want, without having all of these books.

Mr. HARTSON. I think so.

The CHAIRMAN. Bring the original returns and any amended returns.

Mr. HARTSON. Yes, sir.

The CHAIRMAN. Then you will have no objection to their not bringing these books?

Senator COUZENS. Not a bit. As far as I am concerned, that is all I have to-day, Mr. Chairman.

The CHAIRMAN. Mr. Nash has one or two things he wishes to present.

Mr. NASH. I have some exhibits the committee has asked for.

The CHAIRMAN. All right, tell us what they are, Mr. Nash.

Mr. NASH (reading):

MARCH 27, 1924.

Hon. JAMES E. WATSON,
Chairman Special Committee of the United States Senate to Investigate the Bureau of Internal Revenue.

MY DEAR SENATOR: Under date of Monday, March 24, at the meeting of the special committee, Senator King made the following request:

"I would like Mr. Nash to furnish me information as to the number of cases Wayne Johnson, Carl Mapes, and Angevine and others in that office had, and what disposition has been made of those cases, what refunds have been secured by officials of that firm, and how many of that firm have been in the office of the Internal Revenue Bureau."

As to the question as to how many of that firm have been in the office of the Internal Revenue Bureau, there follows a copy of an announcement card gotten out by the firm referred to under date of January 1, 1924:

"Johnson & Shores, 100 Broadway, New York.

"The firm of Crocker, Johnson & Shores having dissolved, Messrs. Wayne Johnson, Lyle T. Alverson, Fred R. Angevine, A. G. Maul, and C. A. Buckley announce that they have formed a partnership for the practice of law at the above address under the name of Johnson & Shores.

"A. J. Shores, Esq., will be of counsel.

"Carl A. Mapes, Esq., will be associated with the firm with offices in the Federal American Bank Building, 1317 F Street NW., Washington, D. C.

"Telephone Rector 5560–5564, inclusive.

"January 1, 1924."

Of the names mentioned on the announcement card quoted, Messrs. Wayne Johnson, Lyle T. Alverson, Fred R. Angevine, and Carl A. Mapes were formerly connected with the Internal Revenue Bureau. The other men mentioned in the announcement have never been connected with the bureau in any capacity.

The records of the bureau as to the number of cases handled by tax representatives do not go back to a date later than July, 1922. This record shows that since that time the firm of Crocker, Johnson & Shores filed powers of attorney in 81 cases; that Mr. Wayne Johnson filed powers of attorney in 18 cases; that Mr. Carl Mapes filed powers of attorney in 22 cases; that Mr. Fred R. Angevine presented powers of attorney in 27 cases; and that Mr. Lyle T. Alverson had powers of attorney in 20 cases.

With reference to the request for information as to what diposition has been made of the cases handled by the persons mentioned and what refunds have been secured by officials of that firm, you are informed that section 3167 of the Revised Statutes prohibits the bureau from giving to the committee information of this character. It would seem, however, that the members of the firm could give such information, with the acquiescence of the taxpayers they have represented.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

The CHAIRMAN. There is one piece of information that you might have given, but did not; that is, when those men of that partnership became engaged in the Internal Revenue Bureau, and when they severed their relations with it. It would be of some value to know that.

Mr. NASH. I can only give that by recollection, Mr. Chairman. I believe that Mr. Wayne Johnson resigned from the bureau in 1920.

The CHAIRMAN. How long had he been there?

Mr. NASH. I do not know. Mr. Hartson, do you know?

Mr. HARTSON. I haven't any idea how long he was solicitor. He was solicitor for less than a year.

Senator COUZENS. Let me suggest that they prepare that and deliver it to us at another hearing.

The CHAIRMAN. You can get that?

Mr. HARTSON. Oh, yes.

The CHAIRMAN. You may do that.

Mr. NASH. Senator Couzens asked for the testimony which had been taken by the commissioner during an investigation in the early part of 1921. I have that testimony, with letter of transmittal, dated March 31, which reads:

MARCH 31, 1924.

Hon. JAMES E. WATSON,
Chairman Committee Investigating the Bureau of Internal Revenue, United States Senate.

MY DEAR SENATOR: I am sending, herewith, the testimony of 24 witnesses taken in 1921 in an investigation which I caused to be made because of certain vague rumors that were afloat at the time I became Commissioner of Internal Revenue.

There was a condition of unrest existing at that time and there were many charges of collusion, and I made the best effort I could to ascertain whether or not these charges were well founded. After carefully considering the testimony as taken I came to the conclusion that the rumors in the main were without

foundation. As a result of the investigation two employees, who had been most active in circulating reports both inside and outside of the bureau, were dismissed from the service, and one other was transferred to another unit and refused to return to his work and was dropped from the rolls on that account. The investigation, I believe, had a wholesome effect.

The records were later turned over to the committee on enrollment and disbarment and they have been in the possession of that committee until called for by your committee.

Sincerely yours,

D. H. BLAIR, *Commissioner.*

The CHAIRMAN. We do not want to include that whole transcript in this record.

Senator COUZENS. No.

The CHAIRMAN. You can just look it over and satisfy yourself about it and use as much of the contents as you desire to use.

Senator COUZENS. That is correct.

The CHAIRMAN. And then return them.

Senator COUZENS. Yes.

Mr. NASH. In the testimony of Mr. May a few days ago he referred to a revenue agent, Kennedy, in the case of the West Virginia Pulp & Paper Co.

The CHAIRMAN. Yes.

Mr. NASH. Who had mentioned this case to an outside attorney.

The CHAIRMAN. Yes.

Mr. NASH. The bureau investigated that case, and I have a brief summary of the case, if the committee desires it to go into the record.

The CHAIRMAN. Yes; read it in, because it was mentioned before.

Mr. NASH (reading):

MARCH 27, 1924.

Mr. BLAIR:

A review of the file in the case of Mr. George B. Kennedy, formerly an auditor in the Income Tax Unit, concerning charges preferred against him by an employee of the West Virginia Pulp & Paper Co., discloses the following:

It was charged that Mr. Kennedy, upon completion of his examination of the books of the company in question, stated there would be a considerable amount of additional tax due and suggested that the company get in touch with Judge T. P. Ansberry, an attorney in Washington. The investigation disclosed that Mr. Kennedy, who was a personal friend of Judge Ansberry, requested the company in question to cash a personal check made in his favor by Judge Ansberry some time after the completion of the investigation. Kennedy stated that in making this request he may have remarked at the time that Judge Ansberry was all right and probably would be a good man to know if the company ever had any legal matters in Washington, but that he had never made any mention to the representative of the company of tax matters. A review of all of the cases handled by Auditor Kennedy disclosed that in no case had Judge Ansberry or anyone else associated with him appeared as representative of the taxpayers. In view of this, and the further fact that the request for the cashing of the check was made after completion of the audit of the books and the complaint of the taxpayer was not made until almost two years after the incident complained of, and there was simply a question of the word of the representative of the taxpayer against that of the auditor as to the actual statements made by the latter, it was decided that the bureau would not be justified in removing the auditor. He was reprimanded and cautioned that he should not ask taxpayers, whom he was investigating or had investigated, to cash personal checks for him.

ELMER L. IREY,
Chief, Special Intelligence Unit.

Senator COUZENS. Can you tell me when the law first provided for allowances for amortization?

Mr. NASH. I think Mr. Hartson can answer that more specifically.

Mr. HARTSON. For amortization allowances?

Senator COUZENS. Yes.

Mr. HARTSON. Only since the 1918 act. That was upon amortization of facilities erected or maintained for production of articles which contributed to the prosecution of the war. It was specifically a war measure, and was put into the 1918 act.

Senator COUZENS. In what year did amortization accumulate to the Gulf Oil Co.?

Mr. NASH. Expenditures on which amortization might be allowable would have to be made after the beginning of the war, which was on April 6, 1917, and had to be terminated; that is to say, there could not be any further expenditures after the signing of the armistice, except such expenditures as were necessary to protect any investment that had been started before the signing of the armistice. Do I make myself clear?

Senator COUZENS. Yes. When did this amortization claim accrue as to the Gulf Oil Corporation?

Mr. HARTSON. It was a properly deductible item from gross income for the year 1917, if they made any expenditures during that year, 1918, and a part of 1919, providing that those expenditures——

Doctor ADAMS. Is the solicitor correct about 1917?

Mr. HARTSON. I think I am not correct, as Doctor Adams calls my attention to it. As a matter of fact, the 1917 act was also a war measure act, and it provided for the allowance.

Doctor ADAMS. No; I think you could not use amortization allowances prior to January 1, 1918. I am not absolutely certain, but I think you will find it is not a deduction applicable for the year 1917.

Senator COUZENS. Mr. Hartson, can you bring to the committee the amortization claim of the Gulf Oil Corporation, showing the type of construction that was done, what the amortization claim was on, the particular years, and the items. I do not ask for the original records, but bring us a synopsis of the record as it applied to the amortization claim called for as I understand, by the Gulf Oil Corporation.

Mr. HARTSON. Yes, sir.

Mr. NASH. Mr. May, in his testimony also mentioned an income tax expert by the name of D. E. Townsend. I have his personal history and his connection with the bureau.

He was appointed in the Internal Revenue Bureau on March 26, 1918, at a salary of $5,000 per year. He apparently left the bureau and was reappointed for three months at $5,000 on August 22, 1918, and resigned from the bureau on March 15, 1919.

You will recall that this was the gentleman that Mr. May testified he had found had received a $60,000 fee from one of his clients.

Senator COUZENS. Do you know whether that is true, that he did receive that? Have you any record of it?

Mr. NASH. I have not heard of it, except in Mr. May's testimony.

Mr. HARTSON. I would like to correct that amortization point there. The first statement was correct. The first allowance for amortization was in the 1918 act, which was not made retroactive. It was only effective beginning with the 1st of January, 1918.

Senator COUZENS. So that any investment made in 1918, that was made for war purposes, was the only investment which was allowed to be amortized?

Mr. GREENIDGE. No.

Mr. HARTSON. Roughly speaking, that is correct.

The CHAIRMAN. Let us find out about that.

Doctor ADAMS. Only for articles contributing to the prosecution of the war.

The CHAIRMAN. That had better be straightened out.

Mr. HARTSON. Mr Clack can explain that to us, gentlemen. He is one of our amortization engineers.

STATEMENT OF MR. J. M. CLACK, AMORTIZATION ENGINEER, INTERNAL REVENUE BUREAU

The CHAIRMAN. State your full name for the record.

Mr. CLACK. J. M. Clack.

Senator COUZENS. How long have you been in the bureau, Mr. Clack?

Mr. CLACK. Since January 1, 1922.

Senator COUZENS. Proceed and give us the method used in arriving at amortization.

Mr. CLACK. Well, I assume the committee is familiar with the revenue act providing for amortization, and which, briefly stated, provides that the taxpayer, in computing its net income, take a loss or a deduction for facilities, buildings, equipment or other machinery installed or erected or acquired for the production of articles contributing to the prosecution of the war and the difference between cost and value in use in their post-war business. Those expenditures are limited from April 6, 1917, until the cessation of the taxpayer's war work, but amortization allowed on 1917 expenditures is a deductible item from 1918 income only.

The CHAIRMAN. Only from the 1918 income?

Mr. CLACK. Yes, sir; it is not deductible from the 1917 income; but on expenditures made in 1917, if the taxpayer bought facilities in 1917 on which he afterwards suffered a loss, he is allowed to take a deduction on his 1918 return for the amount of that loss.

Senator COUZENS. Was there any amortization allowed for land?

Mr. CLACK. Sometimes, if a loss is proven. If land was clearly acquired in connection with the building of a factory, for instance, for war work, and it is clearly proven that it was necessary to pay a larger price for it than its postwar value, amortization is sometimes allowed on that.

The CHAIRMAN. Was amortization allowed after the signing of the armistice on November 11, 1918?

Mr. CLACK. Yes, sir; in a number of cases. In the cases of shipyards, for instance, if a taxpayer had a contract for building a ship that was not completed until 1919, or even in 1920, and in order to complete that contract it might have been necessary for him to make expenditures in 1919 he could be allowed amortization on those expenditures.

Doctor ADAMS. Is that applicable to other corporations than to shipbuilding concerns?

Mr. CLACK. That applies to any contract under which the contractor, in effect, had obligated himself, prior to the armistice, for a contract which he did not complete until after that.

The CHAIRMAN. It had reference to war production?

Mr. CLACK. Yes; war production.

Doctor ADAMS. Even though it was known that it could not be completed before the close of 1918?

Mr. CLACK. At the time the contract was given, of course, it was not known when the war would be completed.

Doctor ADAMS. The expenditures made in pursuance of contracts made in good faith, before the war ended, can be amortized?

Mr. CLACK. Yes, sir.

Senator COUZENS. Do you know of any number of cases where land was allowed to be amortized?

Mr. CLACK. I do not recall any definite cases, Senator. There were comparatively few of those. As a general thing, the department takes the position that unless it is very clearly shown that the post-war value of the land is equal to its cost——

Senator COUZENS. In the claim that the Department of Justice had against the Lincoln Motor Co. of Detroit, I understand that there was a considerable portion of the claim allowed for amortization of land. Is it in the law that that might be given, Mr. Hartson?

Mr. HARTSON. Oh, yes. The law is broad enough so that it does not confine it to any specific character or type of property.

Senator COUZENS. What I mean is, may you give the allowance in the case of the Lincoln Motor Co.?

Mr. HARTSON. I would not think so, unless we had some waiver of some kind.

Senator COUZENS. It was in the suit that was filed by the Department of Justice for claim of some $9,000,000 made against the Lincoln Motor Co., and that was settled eventually on the basis of $1,550,000.

Mr. HARTSON. If it is a matter of a public record in a court of law, I see no objection to it. I was not familiar with that suit.

Senator COUZENS. Will you look that up for us?

Mr. HARTSON. Yes, Senator.

Senator COUZENS. That is all.

The CHAIRMAN. Then we will adjourn until 2 o'clock to-morrow afternoon.

(Whereupon, at 4.35 o'clock p. m., the committee adjourned until to-morrow, Tuesday, April 1, 1924, at 2 o'clock p. m.)

BUREAU OF INTERNAL REVENUE

TUESDAY, APRIL 1, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 2 o'clock p. m., Senator James E. Watson presiding.

Present: Senators Watson (chairman) and Couzens.

Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. N. T. Hartson, Solicitor Internal Revenue Bureau; and Mr. S. M. Greenidge, head engineering division, Internal Revenue Bureau; Dr. T. S. Adams, tax expert, Yale University.

The CHAIRMAN. The committee will be in order.

Senator COUZENS. Mr. Hartson, as I recall it, the information that was asked for in connection with the Gulf Oil Corporation will not be ready to-day. Have you the information as to the other companies?

Mr. HARTSON. Yes; we have, Senator. We have, for instance, the Berwind-White Coal Mining Co. and the Lee Smith Manufacturing Co. Those are the two that were mentioned, and we have now the Aluminum Co. of America and the Standard Steel Car Co. Those can be taken up in the order that the Senator desires.

Senator COUZENS. Suppose we start in with the Berwind-White Coal Mining Co., if you have that.

Mr. HARTSON. I will ask Mr. Clack to present that.

STATEMENT OF MR. J. M. CLACK, INTERNAL REVENUE BUREAU—Resumed

Senator COUZENS. What papers have you with you here, Mr. Clack?

Mr. CLACK. I have all of the files, Senator. I have here a memorandum of the amortization claimed and the allowance.

Senator COUZENS. I would like to see, if you have the returns that were made, how the criticism was directed by the witness.

Mr. HARTSON. If you recall it, Senator, the witness was criticizing the amortization allowance and made no reference to any other allowance granted to the company. That is my recollection of it.

Senator COUZENS. That is correct, but what year was that?

Mr. CLACK. 1918 or 1919. I have a memorandum here, Senator, of the amortization deduction that was taken in the original return in 1918 or 1919 and the subsequent allowances that were made.

The CHAIRMAN. Who was that witness, Mr. Hartson?

Mr. HARTSON. That was the witness by the name of Adams.

The CHAIRMAN. Oh, yes; I recall.

Mr. HARTSON. He was formerly an employee of the bureau.

The CHAIRMAN. Yes.

Mr. CLACK. I think, Senator, this memorandum will give you the information. We have the returns there.

Senator COUZENS. You may proceed to make your statement, and we will see.

Mr. CLACK. The amortization claimed in the original returns of the Berwind-White Coal Mining Co. was, in 1918, $257,668.16, and in 1919, $66,966.10.

Senator COUZENS. So as to have some continuity to your story, just tell us what the character of the properties was on which this amortization was claimed, and when they were constructed.

Mr. CLACK. The property on which the amortization was claimed consisted of a power plant. The Berwind-White Coal Mining Co. engaged in the operation of a number of coal mines, during the war, during 1918 and 1919, they built a large power plant for the operation of those mines, and also for supplying power for various commercial uses to other corporations in that vicinity.

Senator COUZENS. What was the cost of the plant?

Mr. CLACK. The cost upon which amortization is claimed was $825,722.44.

Senator COUZENS. And from those figures previously given, they have claimed amortization of approximately $500,000?

Mr. CLACK. Well, in the original returns, the two returns, the total was $324,634.26.

Senator COUZENS. That was the total on their $800,000 investment?

Mr. CLACK. Yes, sir; claimed in their original returns.

Senator COUZENS. Yes; I understand.

Mr. CLACK. They afterwards submitted a revised claim in which they claimed $575,591.31. They increased the amount of the claim.

Senator COUZENS. What was the purpose of filing that amended claim in increasing the deduction from something like $300,000 to some $500,000?

Mr. CLACK. For one reason, the 1918 revenue act limited the amount of amortization that could be deducted to 25 per cent of the cost. Some taxpayers claimed greater percentages of deduction than that in their original returns. They did that in a great many cases. When the returns were audited, the taxpayers were required to submit supporting data to substantiate their claims, and in a great many instances when that was done they increased the amount of the claim.

Senator COUZENS. Yes; but it was limited by law to 25 per cent.

Mr. CLACK. The law limited the amount to that—not the allowance that should be made, but the amount that they could deduct from their 1918 return only, a somewhat tentative allowance. It was apparently the intention of the law. It did not appear to be the intention of the law, and I do not think it was the law, that the total deduction should be limited to that amount.

Senator COUZENS. Mr. Hartson, will you please tell us what your interpretation of the law is with respect to that?

Mr. HARTSON. Senator, I was not following the testimony of the witness up to that point. I was reading a statement here, and I would like to have the stenographer read what the witness said.

Senator COUZENS. Perhaps, I can state it more briefly than the stenographer can read it. It was this: The witness said that the law of 1918 limited the claims for amortization to 25 per cent of the investment, but he placed a different interpretation on that. He said he did not think that that was the maximum that was intended to be put on it. What is your understanding of it?

Mr. HARTSON. My understanding is that the regulations were what limited the amount that might be allowed. Am I not correct in that?

Mr. CLACK. Yes.

The CHAIRMAN. There was no such limitation in the law.

Mr. CLACK. No.

Mr. HARTSON. I am inclined to think that there was not.

The CHAIRMAN. It was purely a matter of regulation.

Mr. HARTSON. Of course, the regulations could not limit the amount claimed or that might be claimed. The best that could be done under the regulations, as a regulatory measure, was to prohibit the bureau from allowing anything in excess of 25 per cent of the cost.

Mr. CLACK. I may state, Senator, our section's understanding of the law. The 1918 returns were filed early in 1919, and at that time it was impossible to determine the amount of amortization to which a taxpayer might be entitled eventually; so that the regulations limited the amount that he might take at that time to 25 per cent of the cost; but there was no provision to prevent him from claiming a larger amount than that, of course, and larger percentages than that were allowed in many instances, and were justified.

Doctor ADAMS. Was that the basis of the increase? Was that the reason for the increase in this case?

Mr. CLACK. I could not answer that question, as to what the reason for the increase in the claim was.

Doctor ADAMS. Was not your previous explanation given as an explanation of the probable increase in the claims?

Mr. CLACK. Yes, sir; it might have happened that at the time the 1918 return was filed, the taxpayer, where large amounts were involved, was unable to determine the amount of its loss. The revised claim would be filed a year later, and at that time the taxpayer's idea of the amount that he was entitled to might be entirely different from what it was at the time he filed his return. That, I think, is the real reason for the difference in the claim.

Doctor ADAMS. You are then offering no explanation of this specific increase in the claim? You say it may have happened in several ways, but you do not say in which way; is that correct?

Mr. CLACK. Yes, sir; I do not know. The deduction taken in the returns as a general thing did not carry full supporting data, and in an investigation of the claim, the department would call on the different taxpayers for supporting data, and in probably 90 per cent of the cases the revised claim was larger than the original deduction. In 1921, you will remember, it was a very bad year, and in claims that were filed at that time the taxpayers had a very low opinion of the value of their property, in many cases.

Doctor ADAMS. The 25 per cent limitation that you speak of applicable to amortization claims for the year 1918 was a temporary and provisional limitation, was it not?

Mr. CLACK. Yes, sir.

Doctor ADAMS. That was to be adjusted later on.

Mr. CLACK. So that the revised claim of the Berwind-White Coal Mining Co. was filed on October 1, 1921, and was for $575,991.31 on a cost of $825,722.44. That claim was investigated by Engineers Woolson and Moore, and in a report dated May 12, 1922, they recommended that the claim be disallowed in full.

Senator COUZENS. For what reason?

Mr. CLACK. The disallowance apparently was based—I have read over the report—on the viewpoint of the engineers that the amortized property, which, as you will remember, consisted of a power plant, had furnished power for the operation of several mines and also for commercial purposes. The engineers took the position that when all the mines were in operation at one time and the commercial demand was also at its peak, the plant was no larger than necessary, that no excess capacity existed. The mines at that time were only in operation about three days out of a week, or an average of about half time. The subsequent allowance that was made was based upon the average production of the mines throughout the year; and since the mines were only in operation a part of the time, that the power plant was only in partial use.

Senator COUZENS. Then you took the worst year that there was before the war and used that as the basis in arriving at the average use of the plant?

Mr. CLACK. It was not based on 1921 Senator.

Senator COUZENS. You just stated the year, the average for the year 1921.

Mr. CLACK. Well, if I did, I did it unintentionally. I spoke awhile ago about 1921 being a bad year, just as an instance; but in these cases, the amortization allowances, in general, are based upon the average production of 1921, 1922, and 1923. Considering the average of those three years as an index of normal post-war business——

Senator COUZENS. You could not take 1923 to any extent, because the 1923 report has not yet been filed.

Mr. CLACK. I could not in this case; no, sir.

Senator COUZENS. But we are talking about this case and not what you might have used in other cases.

Mr. CLACK. Well, the allowance that was subsequently made, Senator, was made on October 21, 1922. At that time, we took 1921, 1922 to date, and made an estimate for 1923.

Senator COUZENS. And what did you arrive at?

Mr. CLACK. The second investigation was made by Engineer Swarem, and in a report dated October 21, 1922, Mr. Swarem recommended an allowance of $176,953.25. That is on the same cost.

Senator COUZENS. On the same cost?

Mr. CLACK. Yes, sir.

Senator COUZENS. It related to the same claim of $575,000?

Mr. CLACK. Yes, sir; practically the same claim—for exactly the same claim that was disallowed in the first case. In the second investigation, there was an allowance made of $176,000. Subsequently, the taxpayer protested that allowance also, and submitted additional data to show that the percentage in use was lower than the engineer computed, and, on the basis of the later data that was filed, an allowance was eventually made. The total allowance that was made was $373,401.12. I have that date, I think.

Senator COUZENS. Who arrived at that allowance?

Mr. CLACK. The same engineer, Mr. Swarem, made the second report.

Senator COUZENS. What caused him to make the second report, after he had agreed on $176,000?

Mr. CLACK. His report states that it was based upon additional data submitted at the conference.

Doctor ADAMS. Do I understand that that allowance was based on excess capacity?

Mr. CLACK. The final allowance was made in part on excess capacity, and in part on replacements. Originally, the 1918 act provided for allowances only on the basis of excess capacity. The 1921 act also added to that an allowance on the basis of post-war replacement cost.

Senator COUZENS. Was that made retroactive?

Mr. CLACK. It was applied to amortization; yes, sir.

Mr. HARTSON. Mr. Clack, when you refer to the act, you mean the regulations, do you not?

Mr. CLACK. I mean the regulations.

Mr. HARTSON. The act does not go into that in detail.

Mr. CLACK. No.

Doctor ADAMS. Those were changes in regulations in the statute, in the language.

The CHAIRMAN. You had nothing to do with the figuring of this and making this final decision, had you?

Mr. CLACK. No, sir.

The CHAIRMAN. As you have looked it over or have investigated since, do you think it was just or unjust, fair or unfair?

Mr. CLACK. Of course, Senator, several engineers were employed for several weeks in making up the claim. One of our engineers went over and made a physical examination of the property, and any statement that I can make about that would be without a very solid foundation.

The CHAIRMAN. I am merely asking your opinion about it, without regard to whether you consider it solid or not.

Mr. CLACK. Well, in my opinion——

The CHAIRMAN. You are in the department?

Mr. CLACK (continuing). Judging from the reports submitted, the allowance does not appear to be out of line.

Senator COUZENS. I do not think the chairman can expect that the witness would make a statement against his own department.

The CHAIRMAN. I do not know. I would expect him to give an opinion that would reflect his honest thought on the subject.

Mr. CLACK. Senator, I will say this: This case contains a number of complications from the very nature of the case. The power plant which operates the taxpayer's mines also sells power. It is a somewhat technical proposition to fix its capacity and the value of its use.

Senator COUZENS. Right at that point, let me ask you what was the reason for this extension at this time?

Mr. CLACK. Of the building of the plant?

Senator COUZENS. Yes.

Mr. CLACK. The taxpayer had a pre-war power plant, which was too small, and which was somewhat deteriorated from age. On account of the great demand and urgent need for coal during the war

period, they found it necessary to build a new plant, in order to meet that situation, to take care of their part in helping to win the war.

Senator COUZENS. Did they have a contract with the Government?

Mr. CLACK. I do not remember.

Senator COUZENS. Do we understand that the policy was or that the law was that a demand for business, of no matter what kind, would enable the taxpayer to make a claim upon the Government, because he saw great profits in the business and built extensions to his plant, no matter what it may be?

Mr. CLACK. On certain articles, such as coal, the department has practically taken the position that it is not necessary to show a direct Government contract.

The CHAIRMAN. How is that? You say they had a direct Government contract?

Mr. CLACK. No; I say the department has taken the position that it is not necessary to entitle a taxpayer to amortization, a taxpayer producing such an article as coal, to have a direct Government contract, in order to be entitled to amortization.

Senator COUZENS. Then that whole matter you contend was discretionary with the department?

Mr. CLACK. Well, the uniform practice has been to allow all coal producers who claimed amortization of facilities which they put in during the war period to increase their production.

Senator COUZENS. I understand that, but you contend that it was discretionary with the department to select such trades or businesses, that it deemed wise, to allow these claims on; is that correct?

Mr. CLACK. Yes, sir.

Senator COUZENS. Do you know what lines of trade were thus selected on which amortization was allowed?

Mr. CLACK. The line is still somewhat vague, Senator Couzens.

Senator COUZENS. I think that is a very great weakness in the department. In other words, if I make a good showing by going and getting a tax expert, I could probably show that I was justified in extending my brewery, if I had one, so as to put pep into the men building ships, and I would thereby get an allowance for extending my beer plant during the war.

Mr. HARTSON. Now, Senator, I think possibly the law itself should be called to your attention, and the specific terms pointed out.

Senator COUZENS. I am talking about the witness's statement, as I understood him.

Mr. HARTSON. I think the witness did not intend to say that for any costs expended by the taxpayer during the war, it was amortizable at all. The law restricts it to certain things.

Senator COUZENS. What are they?

Mr. HARTSON. It allows the department to determine whether under a certain set of facts a taxpayer expended money for those things authorized by the law.

Senator COUZENS. Just what does the law say?

Mr. HARTSON. The law says:

In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of

such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income.

Now, the essential thing that must be pointed out there is that the law limits it to expenditures made for the production of articles contributing to the prosecution of the war.

It is true that coal has been ruled upon by the department to have been an article which, in its production, contributed to the prosecution of the war against Germany, and many other articles.

Senator COUZENS. Can you name them?

Mr. HARTSON. The list would be too long. I can not name them out of mind, but, for instance——

The CHAIRMAN. Well, all munitions; powder plants, if I remember correctly, and plants manufacturing arms. Those things have been up in the Treasury Department, as you know, for a long while.

Doctor ADAMS. The question of coal, Senator, was specifically considered by the committees in connection with this, and it was the thought of those Senators who expressed themselves as being included within this definition.

Senator COUZENS. I am not questioning whether the allowance of amortization was authorized. I am raising the question as to whether the allowance throughout was equitable between the industries. Suppose I were a farmer, for instance, having 100 acres of land, and that I know of another hundred acres of land that needs draining, cutting, and fixing up, and I buy that hundred acres at a high price and put it in shape for growing wheat. Does the bureau allow the farmer amortization on the extra hundred acres he bought? Do you know of any such case as that?

Mr. CLACK. No, sir.

Senator COUZENS. Then, the farmer has not been able to amortize the land that he bought at high prices, or whatever implements he might have bought to increase the wheat production, with which to win the war, as I understand it. Is that correct?

Mr. CLACK. That is correct.

Senator COUZENS. I therefore bring up the question that this matter of amortization has not been equitably allowed amongst the taxpayers. That was my reason for raising the question.

Mr. HARTSON. Does the Senator compare the expenditure that a farmer would make in acquiring additional land for the raising of wheat, which has a commodity value and an economic use, quite separate from the production of articles contributing to the prosecution of the war?

Senator COUZENS. I should say it was on a parity with coal, at least.

The CHAIRMAN. When that statute was passed, as I remember it, the one thing pointed out was to get immediately the munitions of war, and the question of food did not enter into consideration. Just read the language of that statute, Mr. Hartson.

Mr. HARTSON (reading):

In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917——

The CHAIRMAN. Yes.

Senator COUZENS. I asked a question the other day about amortization that has been allowed on land, and it was admitted by the witness that amortization credits on land had been allowed.

Doctor ADAMS. It would seem impossible under the language of the statute. Lest the Senator's mind may not be clear on it, I want to say that in the deliberations preceding the adoption of this act agriculture was specifically mentioned by those who were defining the meaning of the phrase "contributing to the prosecution of the war." In other words, the language there is as to buildings, equipment, etc. I doubt if land would be capable of amortization, under the provisions of that statute; but while we are on this subject, I thought it should be mentioned that coal and agriculture were specifically mentioned, and they are on record as being mentioned. In other words, the farmer who put up buildings for the production of grain during the war would unquestionably, in my opinion, be entitled to amortization, if he met the other requirements.

Senator COUZENS. Would he not as to the land, too, because it was allowed in the Lincoln Motor Co. case and other cases as specified by the witnesses here, for the purchase of land?

Doctor ADAMS. I did not know that it had ever been allowed on land.

The CHAIRMAN. That is a strange thing. I did not know that.

Mr. HARTSON. I would like to supplement my own lack of knowledge. I did not know until it was brought out here yesterday that the cost of land could be amortized, but I have since been informed that in the very few cases in which it was allowed it was limited to cases where the land was obtained for the specific purpose of erecting thereon these facilities necessary for the production of articles for use in the prosecution of the war. I think it is a very limited allowance, and it is only in specific cases, where it could be definitely proven that the land was acquired for the purpose of erecting some facilities for the prosecution of the war. Until yesterday I did not know that that had been done.

Doctor ADAMS. Has the solicitor's office passed on that?

Mr. HARTSON. I can not answer that. I do not know.

Senator COUZENS. Take this Berwind-White case. I would like to know, if you can tell me here, and if not, at some future hearing, just the steps that were taken, and who took the steps from the first time that the claim was disallowed, which then amounted to some $575,000, to the next step, by which $176,000 was agreed to when the taxpayer objected, and the next step that was taken, where it was jumped to some $375,000, if I remember correctly.

Now, that is a procedure in the department that I think this committee should know something about, because it undoubtedly places an enormous responsibility upon the department, with an equal opportunity for favoritism, for influence, and even for graft, which I do not for a moment claim, but I do point out that it is a kind of procedure that the Congress should be able to legislate against.

Doctor ADAMS. Senator, do you not want a list of articles for the production of which amortization has been granted? Is not that what you have in mind?

Senator COUZENS. No; I do not care particularly to go into that, but I do point out that there is so much discretion left with the

department, as shown by the steps taken to change, in one case, from the entire disallowance of the claim, by a set of engineers, to another step, allowing $175,000 by another set of engineers, and to another step allowing $375,000 by another set of engineers, that I think it is entirely wrong for Congress to place in the hands of the department so great a responsibility and opportunity for favoritism and the unjust treatment of one taxpayer as compared with another.

Mr. CLACK. If the Senator will permit me to say just a word there in regard to the general policy along that line——

Senator COUZENS. Yes.

Mr. CLACK. It quite often happens—it happens in the majoirty of cases—that in the investigation of a claim the engineer will be of the opinion that the taxpayer is claiming more than he is entitled to. While we endeavor to be fair with the taxpayer, we ordinarily, and naturally, are on the other side of the matter, and we quite often disallow a larger amount than the taxpayer thinks should be done. The taxpayer then protests, and comes in and produces additional facts, perhaps, or submits additional arguments, at a conference of two or three engineers and an auditor, usually, and is able to convince the department that he is entitled to a larger allowance than the engineer first thought he was entitled to.

Senator COUZENS. I am not finding fault with that. I am saying that the law places this power where it is, and it gives such an opportunity for dissatisfaction among the taxpayers, because they are not all treated equally. It has been deduced in the evidence here that the taxpayers who have been urgent and who have been expert enough and able have been enabled to get an allowance that previous taxpayers did not get in the same kind of cases, and no opportunity was given the previous taxpayers to have secured an allowance, even under like conditions, because there was no way in which the department could notify the taxpayer that it had been influenced to make an allowance in a like kind of claim.

Now, while we are on this point, have you any suggestion to make as to how Congress should proceed to amend the law so as to make more rigid the handling of these matters, and thereby relieve the department of so much responsibility?

Mr. CLACK. I am afraid not, Senator. You must realize, of course, that in all of these claims, one man is going to think that he is entitled to a larger amount than another, and he claims a larger amount. One man will claim more than he is entitled to, and another not so much as he is entitled to. The department endeavors, in these different cases, to sit, to some extent, as a board of equalization and to allow all of them a fair amount.

The CHAIRMAN. How did this happen to be submitted to three different sets of engineers?

Mr. CLACK. Because of the protests of the taxpayer.

The CHAIRMAN. And when the taxpayer protests under the procedure and practice of the department, do you always refer the matter to another set of engineers?

Mr. CLACK. No, sir.

The CHAIRMAN. Is it referred back to the same engineer?

Mr. CLACK. As a usual thing, after a protest, the engineer who was on the original claim and another, perhaps an older or more experienced engineer, will sit in with him sometimes, and the chief himself.

The CHAIRMAN. This was referred originally to two engineers, and then to two others, and then to two others; is that right?

Mr. CLACK. No, sir; it was originally referred to two engineers.

The CHAIRMAN. Yes.

Mr. CLACK. And later to a third, a single engineer.

The CHAIRMAN. After the protest was made?

Mr. CLACK. Yes.

The CHAIRMAN. And an appeal was made?

Mr. CLACK. The third time to the third engineer, who made a second determination, and had a conference. I think the record shows that the chief, Mr. De La Mater, sat in the conference in which the final allowance was made.

The CHAIRMAN. A conference with whom?

Mr. CLACK. The taxpayer and his representatives and the engineer. The conference simply refers to the fact that they requested to be allowed to come in and submit additional data and their arguments.

Senator COUZENS. Do your records here show who participated in that conference, outside of Engineer Swarem?

Mr. CLACK. Yes, sir.

Senator COUZENS. Have you them here?

Mr. CLACK. Yes, sir.

Senator COUZENS. Will you please find them for us?

Mr. CLACK. Yes, sir.

The CHAIRMAN. I would like to ask Mr. Nash, while we are waiting for that, whether that is the usual course of procedure, that first the engineer makes out his estimate, and then the taxpayer comes in and files his protest. Then, what have you to do universally?

Mr. NASH. In this case, as in hundreds of other cases, the engineer goes out and makes his examination, and submits his report as to what he sees from making a physical examination. Then, if the taxpayer does not accept the engineer's report, under section 250–D of the law, he is entitled to a hearing before a conference committee in the bureau. The taxpayer brings in additional evidence or data, and which he thinks the engineer may not have considered at all, or considered improperly, when he made the investigation, and usually the engineer who made the investigation, the head of the engineering section, or amortization section, possibly an auditor, the taxpayer and his representatives sit down around a table and thresh it out.

The CHAIRMAN. The taxpayer can bring a lawyer in, if he wants to?

Mr. NASH. Yes, sir.

The CHAIRMAN. You say that is usually done. Was that course pursued in this particular case?

Mr. NASH. I should imagine, from the testimony of this witness, that that was the procedure in this case.

The CHAIRMAN. Then, may another protest be filed after that second hearing by the taxpayer?

Mr. NASH. The taxpayer then has the right to take his case to the committee on appeals and review.

The CHAIRMAN. I understand the witness to say that it has been referred to two engineers, then to another engineer, and then to another engineer before it came to the committee on appeals and review?

Mr. NASH. I do not know that this case went to the committee on appeals and review at all. That has not been brought out; but there were two engineering examinations of the property, the first one by Moore & Woolson and the second one by Swarem, and the third adjustment of taxes was in the conference, and not as a result of a third examination of the property.

Senator COUZENS. In that connection, Mr. Nash, if the engineer who makes the first examination satisfies the taxpayer, that ends it, does it not?

Mr. NASH. Providing it involves less than $50,000 of refund. If the refund is more than $50,000, the case is reviewed by the solicitor.

Senator COUZENS. Yes; but no question of refund enters this case. He makes his claim for amortization, and the engineer goes out and passes upon it, and if the taxpayer does not protest that ends it?

Mr. NASH. No; the entire case is subject to review in the bureau.

Senator COUZENS. Who reviews it in the bureau?

Mr. NASH. The engineering section.

Senator COUZENS. How many engineers review it in that case?

Mr. NASH. Two.

Senator COUZENS. In their review, though, they are required practically to take the word of the first engineer, because of his having visited the property and being familiar with it; is that right?

Mr. NASH. Yes, sir; that is, they take into consideration the whole case in the department and the data submitted by the taxpayer, as well as the data submitted by the engineer.

Doctor ADAMS. Now, Senator, I invite your attention to the fact that, in respect to amortization, a special exception was made by the statute, and both in behalf of the Government and in behalf of the taxpayer, the cases were held open deliberately until March 3, 1924. Now, with respect to all of these allowances, if I may be permitted to say so, all of these amortization claims should have been checked up, with respect to the amount of extra capacity and in respect to the difference in cost at the high prices actually paid and those which would have been paid under stable post-war conditions, and that ought to have been adjusted back to the losses on those things prior to March 3, 1924, either in the taxpayer's favor or against him. That was the design of the statute. The rationale of the whole thing was that the taxpayer entitled to amortization should get the difference between the high prices he paid during the war and the stable post-war prices, and the Government was giving him until three years after the close of the war to ascertain what stable post-war conditions are; so that, under all ordinary circumstances, these cases would all be subject to recommendation and review as to conditions prior to March 3, 1924.

Senator COUZENS. I would like to ask Mr. Hartson how much trouble it would be to tell us how much, from the beginning of the war up to March 3, 1924, was allowed for amortization, both as to excess capacity and increased cost?

Mr. GREENIDGE. Senator Couzens, I might say that, anticipating that, from 15 to 20 people worked on it for two weeks, and it is being typed to-day, and we hope to have those figures for you by to-morrow, covering every case that has been in the division, the number of reexaminations that have been made, the amount originally claimed, and the amounts allowed.

Senator COUZENS. I want to compliment the department for anticipating the requests of the committee.

Doctor ADAMS. Mr. Greenidge, has any case, to your knowledge, been reopened on the Government's side under that provision?

Mr. GREENIDGE. I am informed that there have been three.

Doctor ADAMS. And may I ask this question, and I will put it in pretty long shape in order to get you answer: My impression is that there was a considerable change in the attitude and interpretation of the amortization division from the beginning of its work until the close. That is natural and probably necessary. Now, certain adverse rulings to the taxpayers must have been made in rather large numbers in the beginning of the work. Later on, in particular cases, some of those adverse attitudes were reversed by the bureau of amortization, but such reversals would not be published. Am I not right about that?

Mr. GREENIDGE. All of them would not; no.

Doctor ADAMS. Would any of them?

Mr. GREENIDGE. I do not know why they should not have been.

Doctor ADAMS. How could they be? The only things that are published are the decisions by the commissioner and the decisions of the committee on appeals and review.

Mr. GREENIDGE. Nearly all of the memoranda of the board of appeals and review are published.

Doctor ADAMS. I meant that it you did not ask the solicitor for an opinion, and if you did not go to the committee on appeals and review, it would not be published, would it?

Mr. GREENIDGE. No.

Doctor ADAMS. As a practical proposition and not as implying any censure at all—I do not mean to do that, of course—has the amortization division in any case gone back to the taxpayers and said to them, by a later ruling, "Your case, originally decided adversely, would now be ruled upon favorably?"

Mr. GREENIDGE. I do not know of any such case, but it is possible that information would have become public through contact with other taxpayers; from what we have done in a particular case you can easily see that it might have become generally known.

Doctor ADAMS. It would because of the special privilege of the expert working continuously with the amortization section.

Mr. GREENIDGE. Yes, sir; I should imagine that would.

Senator COUZENS. That was the place where the tax expert really got in his work, was it not, because of his inside knowledge of these facts?

Mr. GREENIDGE. Well, any other professional man, handling commercial problems of any kind, who gets inside information, naturally has that advantage.

Senator COUZENS. Oh, yes; I recognize that; but I tried to distinguish between the Government and private undertakings.

Mr. GREENIDGE. These problems, Senator Couzens, are not as secret as a great many people would have some of us believe. From the comments that I hear on them from the outside, there is not a great deal of secrecy.

Doctor ADAMS. Mr. Greenidge, could you tell the chairman approximately how many cases and the aggregate amounts involved, which raise amortization claims, now remain in your bureau to be settled?

Mr. GREENIDGE. Yes, sir. On Friday, at noon, there were 399.

Doctor ADAMS. Cases?

Mr. GREENIDGE. Yes, sir.

Senator COUZENS. For all years?

Mr. GREENIDGE. Yes, sir; that is the grand total.

The CHAIRMAN. Can you give me the aggregate number that have been settled or adjusted up to the present time?

Mr. GREENIDGE. Probably several thousand, but I will have that figure for you to-morrow.

The CHAIRMAN. Yes.

Doctor ADAMS. Can you answer this final question: Does that limiting date of March 3, 1924, mean that the Government can not or may not make revaluations after that date, or that it only may not make revaluations as to all conditions existing after that date?

Mr. GREENIDGE. I take it that that is as to conditions after that date.

Doctor ADAMS. They may now make revaluations, but they must be made on conditions existing prior?

Mr. GREENIDGE. That is what these 399 cases have been.

Doctor ADAMS. Then you could revive cases on your own initiative if you had any reason to believe that some of these allowances had been excessive in the past?

Mr. GREENIDGE. Yes; we could.

Mr. HARTSON. There has been a recent ruling on that.

Mr. GREENIDGE. As the solicitor has said, the solicitor has recently ruled on that point, and we have some other points coming up before him in the next few weeks.

Doctor ADAMS. The only exception to what you have said would be in the case of a final settlement under section 1312?

Senator COUZENS. For the purpose of getting this case on concise form, I wish the witness would tell us, first, when the claim for amortization was made by the Berwind-White Mining Co., when the amended claim was made, who the first engineer was who physically examined the property, who the second engineers were, who examined the property, and who took part in the conference when the final adjustment was made?

Mr. CLACK. The original claim was in the original returns. There was a deduction taken in the original return——

Senator COUZENS. When?

Mr. CLACK. In the 1918 returns, there was a deduction taken of $257,668.16. That was at the time the taxpayer filed its tax return for 1918. In its 1919 return, it took a deduction of $66,966.10, a total in the two years of $324,634.26.

On October 1, 1921, the taxpayer filed a revised claim for $575,591.31. That claim was assigned to Engineers C. J. Woolson and J. P. Moore, who made an investigation, and under date of May 12, 1922, submitted a report recommending the entire disallowance of the claim.

The Taxpayer, on August 21, 1922, filed a protest to the disallowance, and Engineer J. W. Swarem was assigned to make a second investigation.

Under date of October 21, 1922, Mr. Swarem submitted a report, recommending an allowance of $176,953.25.

Under date of November 18, 1922, Mr. Swarem filed a third report.

Senator COUZENS. Because of the protest of the taxpayer?

Mr. CLACK. No, sir; not because of the protest that I previously referred to, but apparently a third protest, or a later protest. The third report states that it is based upon the previous report and upon conferences held in this unit, October 30 and 31, and November 7 and November 13.

Senator COUZENS. 1922?

Mr. CLACK. 1922.

In the third report, based upon data submitted at those conferences, Mr. Swarem recommends an allowance of $364,482.45.

I stated that we had a memorandum of that conference, Senator, but I find that I am mistaken. The files have a record of a previous conference, but I have had no connection with this case, and was assigned this morning to get the facts together for the committee; but in looking over it, there is a record here of a conference, which I took as a record of the conference referred to, but I find this is a previous conference, and has nothing to do with the last allowance.

Senator COUZENS. What did that conference have to deal with?

Mr. CLACK. This conference was held on September 5, 1922, and refers to the disallowance of the first claim. At that conference, there were present H. C. Middleton, treasurer of the company; F. A. Ulmer, J. E. Philbrick, engineers of the firm of Ernst & Ernst; Mr. Walter W. Bond, conferee of the unit, Mr. A. H. Flournoy, chief of engineers, and Mr. S. T. De La Mater, chief of the amortization section.

Senator COUZENS. What were the conclusions reached by that conference? Have you the record of the conference there?

Mr. CLACK (reading):

Matter presented: Engineer's report on amortization is dated May 12, 1922. Amortization claimed of $519,077.55 was disallowed in full on the basis of complete and continuous use in the going business.

Taxpayer had not requested, and therefore had not received, a copy of the engineer's report prior to the conference.

Engineer's report went to consolidated returns subdivision on May 20, 1922, and auditors from that office are now engaged in examining records of the corporation and its subsidiaries, and it was from the copy of the engineer's report in their hands that the taxpayer became aware of the disallowance of amortization.

Taxpayer at once prepared a brief, in which it stated the engineer's report contained a distinct misrepresentation of the tax as to the value in use in the going business, and that the data compiled by the engineers as a basis for their conclusions were incomplete and in no sense a proper basis on which to determine the actual value in use, and that the engineers did not discuss the points before leaving the taxpayers' office.

Owing to the absence from the office of the engineers who made the investigation and to the questions of fact involved, it was agreed that an engineer would be at once assigned to the case, and that he would, if possible, proceed to the plants sometime during the week of September 11th.

The taxpayer is to be informed in advance of the probable date of the engineer's arrival.

Senator COUZENS. Who signed that report?

Mr. CLACK. Signed by Walter W. Bond, conferee; A. H. Flournoy, chief of engineers; S. T. De La Mater, chief amortization section.

Senator COUZENS. Now, in that case, the two engineers, Woolson and Moore were not in the conference?

Mr. CLACK. No, sir; they were not. It states that they were out of town.

Senator COUZENS. They were out of town?

Mr. CLACK. Yes, sir.

Senator COUZENS. At any time after that, were their conclusions discussed with them?

Mr. CLACK. I find no record of it.

Senator COUZENS. In other words, that is rather a condemnatory report of the engineer who made the first statement, is it not?

Mr. CLACK. Yes, sir; that is not at all unusual.

Senator COUZENS. The engineers are condemned quite frequently?

Mr. CLACK. Yes, sir.

Senator COUZENS. Whether they take care of the taxpayer or the Government, I suppose?

Mr. CLACK. Yes, sir.

Senator COUZENS. Then, you have no record of the conference which was finally had when the case was settled?

Mr. CLACK. No, sir. This states that there were conferences on four different dates. I find no records of those conferences in the files.

Senator COUZENS. Is it customary to have a record made of those conferences?

Mr. CLACK. Yes, sir; it was customary, but it was sometimes omitted. Conferences were sometimes somewhat informal. The taxpayer would come in and submit additional data to support its claim, and no action was taken at the conference at all. Sometimes, in those cases, there was no record made of them, but it was customary, where any distinct change was made in the allowance to keep an absolute record of it.

Senator COUZENS. In this case, there were three conferences of which you have no record?

Mr. CLACK. Four, apparently.

Senator COUZENS. Four conferences of which you have no record?

Mr. CLACK. Yes, sir.

Senator COUZENS. Is not that an unusual number of conferences to have without a record?

Mr. CLACK. Yes, sir.

Senator COUZENS. Have you any explanation as to why no record was taken of those conferences in this case?

Mr. CLACK. None whatever. I haven't any idea, Senator.

Senator COUZENS. Has Mr. Nash?

Mr. HARTSON. Senator, I think it should be pointed out that the witness has testified that he could find no record in the files, It may be that there is such a record, and it may be in some other files. Maybe it is misplaced.

The CHAIRMAN. Is that an ususual number of conferences to have in a case?

Mr. HARTSON. No.

The CHAIRMAN. When there is a conference held, is a stenographer there to take down what is said?

Mr. HARTSON. No, sir.

The CHAIRMAN. How do they make up the records, then?

Mr. HARTSON. The basis for making up the record of the conferences is that after the conference is over, to have the man who either sat in it or conducted it to dictate to his stenographer his recol-

lection of what occurred, and then have the others present on the part of the Government to initial it or sign it. There are not any facilities afforded for taking down, by way of stenographic notes, the record of a conference. It is not done; there are too many of them going on, to do that.

Doctor ADAMS. Could Mr. Nash give us a rough estimate of the number of conferences taking place each day? I think that has a very direct bearing on this question of possible publicity.

Mr. NASH. There are hundreds of them every day.

The CHAIRMAN. Hundreds?

Mr. NASH. Yes, sir.

Senator COUZENS. Getting back to this case again, where would these references to these conferences be, if they are not in these files?

Mr. CLACK. I looked through those somewhat hurriedly. It may be that they are in those files there. If not, they may simply have been misfiled. I think we have there all of the files in this case. In any filing system, it is, of course, possible for papers to get in the wrong jacket, and when they do, they are pretty hard to find.

Senator COUZENS. I recognize that, but the charge has been made that cases disappeared from the files, and therefore anything that was not wanted in the files might be purposely gotten out of the files.

Mr. HARTSON. I think this would be the proper place to point out that the man who referred to this case, in this instance, was the man who refused to answer my question as to whether he had taken any other copies of reports out of the files in these cases. He did admit, in answer to the Senator's question, that he had a copy of his own report that he filed in this very case.

Senator COUZENS. Yes; he only had a copy, as I remember it.

Mr. HARTSON. Yes; I think that is true.

Senator COUZENS. Not the original.

Mr. CLACK. If the Senator will pardon me, so far as the conference report is concerned, any action that may have been taken on the case at a conference could have been very easily set forth in a conference report, and, frankly, I am very strongly inclined to believe that a memorandum of the conference reports have gotten in the wrong files, rather than that no conference report was made, particularly because of the action that was taken. The increased allowance of from $170,000 to over $300,000 would, of course, have been recorded in that conference.

Senator COUZENS. Would you have had to save the Solicitor's opinion on such an allowance as that?

Mr. CLACK. No, sir.

Senator COUZENS. I will ask you to make a search of the files and see if you can not present to the committee a record of the last conference that you had, where the amount was finally determined upon.

Mr. CLACK. Yes, sir.

Senator COUZENS. I have no further questions to ask this witness.

Mr. HARTSON. I would like to ask Mr. Clack one question.

The CHAIRMAN. All right.

Mr. HARTSON. Do you know whether there was any further review of this case that was taken as a result of this conference, by anybody in the bureau?

Mr. CLACK. Pardon me. You mean of the conference report?

Mr. HARTSON. No; I do not mean of the report—of the allowance. Was there any further review in the bureau of the action of this conference in allowing this amount?

Mr. CLACK. The engineer's report, the third report, in which the allowance is made, based upon that conference, is signed by Mr. Swarem and approved by the reviewing engineers, J. R. Bolling and S. T. De La Mater, chief of section. Mr. Swarem's action, of course, was reviewed and approved by the reviewing engineer and the chief of section.

Senator COUZENS. Was that done after the conference or before the conference?

Mr. CLACK. After the conference.

Senator COUZENS. After the conference?

Mr. CLACK. Yes, sir.

Mr. HARTSON. Did the result of this allowance by this conference take the form of a certificate of overassessment or refund, or what, do you know?

Mr. CLACK. No, sir; I do not know.

Mr. HARTSON. How would you think it would be reflected?

Mr. CLACK. Not knowing what the other disallowances were, the total allowance finally made of $373,000 is only slightly in excess of the deductions that were taken in the original return of $324,000. If there were no other allowances, that would cause a refund to the taxpayer. There was about $50,000 addition amortization allowed, making a possible difference, depending upon the bracket, of $25,000 or $30,000.

Mr. HARTSON. If there is a refund in a case of a substantial amount, would there be any further check on this action?

Mr. CLACK. Yes, sir.

Mr. HARTSON. By review by the solicitor, of the refund?

Mr. CLACK. Yes, sir.

Doctor ADAMS. Mr. Clack, all amortization cases, unless the statute of limitations has run, are open to review with respect to the allowances, are they not?

Mr. CLACK. I beg your pardon.

Doctor ADAMS. All amortization questions are open to review and reexamination, to be recomputed, prior to the date on which the statute of limitations applies?

Mr. CLACK. That is my understanding of it.

Doctor ADAMS. And all of these returns are, in a peculiar sense, open to revision if the statute of limitations has not run?

Mr. CLACK. Yes, sir.

Doctor ADAMS. Do you know whether the statute of limitations has run on these cases this year?

Mr. CLACK. No, sir; I do not. It has not run, of course, on the 1919 deduction allowances.

Doctor ADAMS. It probably would have run on the 1918 returns, would it not?

Mr. CLACK. Unless a waiver had been filed, I presume it would have.

Doctor ADAMS. Was there any effort made to reject these amortization cases before the statute of limitations ran?

Mr. CLACK. No, sir; the section was at that time working under considerable pressure to close out as many of the 1918 cases as possible, in order to avoid having to take waivers.

Doctor ADAMS. A great amount of amortization has been taken for the year 1918, has it not?

Mr. CLACK. Yes, sir.

Doctor ADAMS. In other words, owing to the pressure of work and lack of force, the major precaution taken by the statute has been ignored, apparently?

Mr. CLACK. If I may say just one more word about this additional allowance, there was one feature that I spoke of a while ago regarding the 1921 act providing for replacement—allowance of amortization on replacement cases.

Senator COUZENS. Are you referring to the law or to the regulations?

Mr. CLACK. The regulations.

Senator COUZENS. You ought to make that straight.

Mr. CLACK. Pardon me. The regulations provide that the allowance for amortization might be made on the basis of replacement costs. That regulation was issued some time in the spring of 1922. That is my recollection, and that feature was not given any consideration by anybody in determining this claim.

Senator COUZENS. Then, in other cases that were settled, where the taxpayer was quieted, he got no allowance for excess costs, did he?

Mr. CLACK. No, sir.

Senator COUZENS. I think we are ready to take up the case of the Standard Steel Car Co. now. Have you the papers in that case?

Mr. HARTSON. They got an allowance for it, if they claimed it, did they not?

Mr. CLACK. Yes, sir; if they claimed it.

Senator COUZENS. I said if the taxpayer had been quieted, and if he did not make any claim, of course, he did not get it.

Mr. HARTSON. Senator, if you now want to take up the Lee Smith Son Manufacturing Co. case, I will call Mr. Newbury.

STATEMENT OF MR. C. B. NEWBURY, ENGINEER, BUREAU OF INTERNAL REVENUE

Senator COUZENS. Will you state your full name for the record?

Mr. NEWBURY. C. B. Newbury.

Senator COUZENS. How long have you been in the department?

Mr. NEWBURY. Two years and five months.

Senator COUZENS. Are you an auditor?

Mr. NEWBURY. No; engineer.

Senator COUZENS. What was the discussion in regard to this matter, do you know, Mr. Hartson?

Mr. HARTSON. This is another case that was referred to by either Mr. Adams or Mr. Moore, both of whom were discharged engineers from the bureau.

Mr. NEWBURY. Woolson and Mr. Moore made the original determination in this case, the same as they did in the Berwind-White case. Before proceeding on this case, would it be out of place for me to make a remark on the last case?

The CHAIRMAN. No.

Mr. NEWBURY. The question of coal land was brought up. We have a solicitor's opinion that coal lands acquired are not subject to amortization. That is in answer to the question that was brought up about land.

Senator COUZENS. No; the matter of the land came up more in connection with the purchase of land for expansion for plant purposes.

Mr. NEWBURY. Lee Smith & Sons Manufacturing Co., of Pittsburgh, are engaged in the manufacture of dental supplies. Prior to the war, they had rented quarters in Pittsburgh. The lease expired, and they had to get a new building to continue their operations. They purchased an old building in Aspinwall, expended $19,355 for the acquisition of a building, and in 1918, they expended $38,122.54 for alterations and improvements.

Senator COUZENS. What did they do?

Mr. NEWBURY. They manufactured dental cement under contract with——

The CHAIRMAN. Dental cement?

Mr. NEWBURY. Yes.

The CHAIRMAN. Nothing but that?

Mr. NEWBURY. Their business consisted of selling false teeth and things like that, in addition to manufacturing cement. They are wholesale dental supply people.

The CHAIRMAN. That is what I understood, but I thought you said they confined themselves to the manufacture of dental cement.

Mr. NEWBURY. In this building?

The CHAIRMAN. Oh, in this building.

Mr. NEWBURY. Yes, sir.

The CHAIRMAN. This building was erected for that particular purpose?

Mr. NEWBURY. The building was acquired. They purchased an old four-story building, which had been previously used as a place for the manufacture of pianos. It was in a run-down condition and they had to expend twice as much as the building cost them to put it into shape so that they could use it.

Senator COUZENS. Just what did they do to promote the prosecution of the war?

Mr. NEWBURY. Manufactured dental cement under a direct contract with the Medical Department, the Dental Corps.

Senator COUZENS. Of the Army?

Mr. NEWBURY. Yes, sir. Their business with the United States Government amounted to some $350,000.

Senator COUZENS. Just proceed and tell us what they originally asked for, and what was allowed, etc.

Mr. NEWBURY. On the basis of this expenditure of $38,122.54, they claimed amortization to the amount of $18,546.

Senator COUZENS. That was for one year, though?

Mr. NEWBURY. Yes, sir. It is a small case.

Senator COUZENS. Then, there was another year, was there not?

Mr. NEWBURY. No, sir; that is all there was.

Senator COUZENS. I thought you called off two amounts that they had added to their plant?

Mr. NEWBURY. They spent $19,355 for the acquisition of the building, and then expended further $38,122.54 for alterations and repairs to make it useful.

Mr. CHAIRMAN. That is $58,000?

Mr. NEWBURY. Yes.

Doctor ADAMS. Was that all in one year?

Mr. NEWBURY. No; the land and building was acquired in 1917, and the improvements were made in 1918.

Doctor ADAMS. After the war, in 1917?

Mr. NEWBURY. Yes, sir. On this cost, they claimed an amortization to the amount of $18,546, which was originally disallowed by Woolson and Moore, on the ground that the building was in full use, and that the replacement cost was no less than the cost of acquisition. The taxpayer took an exception to the report and wrote directly to Secretary Mellon. Do you wish to see that letter? One letter here is addressed to the Treasury Department.

Senator COUZENS. That letter was dated June 8, 1922. I just mention that, in case you want to look it up later. Now, there was one addressed to the Secretary?

Mr. NEWBURY. On July 10. That is the second letter.

The CHAIRMAN. What was the first letter that you handed out there?

Mr. NEWBURY. That is a letter addressed to the department?

The CHAIRMAN. By this company?

Mr. NEWBURY. By the taxpayer; yes, sir.

The CHAIRMAN. Yes.

Mr. NEWBURY. That is the letter to Mr. Mellon personally [producing letter]. The taxpayer was very much incensed when he wrote that letter.

Senator COUZENS. Can you tell me what that is which has been rubbed off of that letter to Mr. Mellon, by the taxpayer, or partly rubbed off? I can not read it.

Mr. NEWBURY (reading):

> No reply required. Matter been taken up. P. F. C. file with case.

The CHAIRMAN. Do you want that letter in, Senator?

Senator COUZENS. I do not think it is necessary. I just want to read this comment from the letter to Mr. Mellon from this taxpayer, dated June 6, 1922:

> Owing to the growing spirit of unrest on the part of decent business men throughout the country, arising from conditions similar to this incident, I am forwarding a copy of my letter on the subject to the President for his information, and remain.

That is just an evidence of the discontent with the department.

The CHAIRMAN. Who wrote that letter?

Senator COUZENS. The taxpayer in this case.

What was done with this case after the first engineers disallowed the claim?

Mr. NEWBURY. This letter was replied to, stating that:

> I have directed an examination to be made for the purpose of considering the complaint made by you relative to the examination of the return of the Lee S. Smith & Sons Manufacturing Co.

The case was referred to the committee on appeals and review, who referred it back to the unit, with the recommendation that it be reexamined in the field. Another engineer was assigned to the case, named E. P. Quirk, who is no longer with us, and in a report submitted on May 15, 1923, he recommended an allowance of $12,645.06, based upon facts which he discovered in his examination.

Senator COUZENS. What were the facts?

Mr. NEWBURY. That the pre-war building which it supplanted was about two-thirds of the size of the building during the war; that the war-time building was not used to the extent that the pre-war building had been, that excess capacity existed, and amortization should be allowed.

Senator COUZENS. Was that allowance concurred in by the committee on appeals and review?

Mr. NEWBURY. They did not take the matter up after he made this report. This report was then submitted to the auditors to make their adjustment for arriving at the tax. This report was dated May 15, 1923, and it went out of our section and, as far as I know now, the case has been closed. There were some adjustments made in 1917 and 1919, and there was very little tax involved; I think possibly either an additional tax or an over assessment of a thousand dollars.

Senator COUZENS. Was this claim settled in conference?

Mr. NEWBURY. No, sir; there was nothing unusual in this case at all.

Senator COUZENS. The engineer's word was taken? After he rejected it, his conclusion was taken?

Mr. NEWBURY. He was given a very complete and comprehensive report, with figures and tabulations.

Senator COUZENS. So it was accepted?

Mr. NEWBURY. Yes, sir.

Senator COUZENS. That is all I want to ask this witness.

Mr. HARTSON. It was reviewed, was it not?

Mr. NEWBURY. It was reviewed by the reviewing engineer.

Mr. HARTSON. In other words, his report, as such, did not allow the claim itself?

Mr. NEWBURY. No; it disallowed about $5,000.

Mr. HARTSON. But subject to the review, it was allowed, with that difference?

Mr. NEWBURY. Yes, sir.

Mr. HARTSON. That is all.

The CHAIRMAN. That is all.

Senator COUZENS. Have you the papers in the case of the Standard Steel Car Co. now?

Mr. HARTSON. Yes, sir; we are ready with that case.

STATEMENT OF MR. W. S. TANDROW, APPRAISAL ENGINEER, BUREAU OF INTERNAL REVENUE

The CHAIRMAN. What is your name?

Mr. TANDROW. W. S. Tandrow.

The CHAIRMAN. Are you in the department?

Mr. TANDROW. Yes, sir.

The CHAIRMAN. How long have you been there?

Mr. TANDROW. Eighteen months.

The CHAIRMAN. In what division are you?

Mr. TANDROW. Appraisal engineer of the Income Tax Unit.

The CHAIRMAN. Have you been such all the time?

Mr. TANDROW. All the time.

The CHAIRMAN. All right, Senator.

Senator COUZENS. Just what is it that you propose to review in this connection, Mr. Hartson?

Mr. HARTSON. I had in mind, Senator, a sysopsis of the history of the case and the file which accompanied the returns. We have returns of the years starting from 1917, I believe.

Mr. TANDROW. Yes, sir.

Mr. HARTSON. And these schedules of allowances for those years.

Senator COUZENS. Will you proceed with the case?

Mr. TANDROW. Do you wish me to read the history of it?

Senator COUZENS. Yes.

Mr. TANDROW. On June 14, 1919, the original return for the year 1918 was received. A deduction for amortization in the sum of $1,220,047.45 was taken.

The CHAIRMAN. What was that date?

Mr. TANDROW. That was on June 14.

The CHAIRMAN. What year?

Mr. TANDROW. 1919.

The CHAIRMAN. 1919?

Mr. TANDROW. Yes, sir.

Senator COUZENS. Was that the calendar year or the fiscal year?

Mr. TANDROW. That was the calendar year.

Senator COUZENS. I thought they were supposed to file those returns by March 15. How is it that this return was not filed until June?

Mr. TANDROW. I can not auswer that question.

Mr. HARTSON. It was probably due to an extension of time, Senator. It may be so.

Mr. NASH. In this particular case, Senator Couzens, the act was passed on February 24, 1919, and it was impossible to get blanks printed, get them distributed, and get the returns filed before March 15, and there was an automatic extension to June 15 in which to file returns.

Mr. TANDROW. On May 15, 1920, an amended return for the year 1918 was received, and amortization in the sum of $1,220,047.45 was taken.

The CHAIRMAN. That is what was claimed?

Mr. TANDROW. Yes; that is what was claimed.

Senator COUZENS. In other words, it was taken off?

Mr. TANDROW. Taken as a deduction under Schedule A-19 on the taxpayer's return.

I may omit reference to the correspondence which relates to this case, and which has no bearing upon the return?

Senator COUZENS. You may just recite them year by year as you have them, until you finish, and then we will go back to that other later.

Mr. TANDROW. On May 3, 1923, a final amended return for the year 1918 was filed, showing a deduction for amortization—that is, for the year 1918—in the amount of $157,535.58.

On May 3, 1923, a final amended return was filed for the year 1919, showing a deduction for amortization in the sum of $2,686,537.06, and on that same date, May 3, 1923, the final amended return was filed for the year 1920, showing a deduction of $195,690.80, as amortization.

The CHAIRMAN. Just what happened with that claim?

Mr. TANDROW. I will just make a summation here.

The CHAIRMAN. Yes.

Mr. TANDROW. The total cost on which amortization was claimed was $4,915,714.69, and the total amortization claimed was $3,071,451.14.

Senator COUZENS. What do you mean by that last statement? You say was allowed?

Mr. TANDROW. No; was claimed.

Senator COUZENS. What was the first figure that you gave us?

Mr. TANDROW. That was the cost on which the amortization was based; that is to say, the taxpayer submitted costs, and on those costs were claimed the percentages.

The CHAIRMAN. Can you tell us briefly what those costs consisted of?

Mr. TANDROW. Principally they covered the installation of facilities used in the manufacture of cars, which were delivered to the Government under Government contract. The total contracts amounted to $200,000,000.

The CHAIRMAN. That is to say, this company had a contract with the Government to make cars to be delivered to the Government?

Mr. TANDROW. To the Government?

The CHAIRMAN. Yes; the contract amounting to $200,000,000.

Mr. TANDROW. In the aggregate; yes.

The CHAIRMAN. And in order to meet that demand, they expended some $4,000,000 plus for increased facilities?

Mr. TANDROW. Well, yes; I would say they probably spent $10,000,000, but they only claimed amortization on half of that—about $5,000,000.

The CHAIRMAN. Yes; that is what I want to get. Do you know how much they spent altogether for increased facilities to meet this new contract?

Mr. TANDROW. Well, I could not tell you the exact amount. I know that they claimed amortization on approximately $5,000,000

The CHAIRMAN. Yes; that is amortization.

Mr. TANDROW. Yes.

The CHAIRMAN. But that had no reference to how much they expended?

Mr. TANDROW. No; but that would represent, I would say, roughly, 50 per cent of what they expended.

The CHAIRMAN. And approximately 50 per cent of what they expended they asked to be amortized?

Mr. TANDROW. Yes, sir.

The CHAIRMAN. There was amortization claimed for that?

Mr. TANDROW. Yes.

The CHAIRMAN. Can you give the successive steps, and what was done with each claim when it was filed?

Mr. TANDROW. Yes; I have it set up chronologically in this statement.

Senator COUZENS. In this statement here?

Mr. TANDROW. Yes.

Senator COUZENS. I just want to read from the last page here, the memorandum under date of July 2, 1923. It says:

Engineer's report on claim for amortization of war facilities. The following is taken from the summary of the report:

"Cost on which amortisation is allowed, $4,915,714.69.

"Amortization allowed for tax purposes, $3,039,763.34."

In other words, nearly 75 per cent of the total cost was allowed?

Mr. TANDROW. No; about 60 per cent.

Senator COUZENS. Well, between 60 and 65 per cent; yes. Is that correct?

Mr. TANDROW. Yes; that is correct.

Doctor ADAMS. What is the equipment that was amortized?

Mr. TANDROW. Principally machinery and some small expenditures covering steel frame buildings, but it was largely very heavy machinery used in car manufacturing.

Doctor ADAMS. And the basis of it was high price, or reduction in use?

Mr. TANDROW. Yes; there were three factors. It was excess cost during the war and depreciation during amortization period, which they normally do not get, and lowered value in use; and, of course, there was a loss of the income producing capacity of the money invested in equipment during the post-war period.

Senator COUZENS. Do you mean that you allow for losses sustained during the post-war period?

Mr. TANDROW. Yes; that is to say, we took the average production for the years 1921, 1922, and 1923, and compared that with proven capacity to ascertain a value in use ratio and applied that to the cost, which gave them the amortization write-off.

Senator COUZENS. How could you take it in 1923, when this case was closed up in the middle part of 1923?

Mr. TANDROW. I had four months in 1923, and I estimated a year on the basis of four months' production, and in order to make an estimate I went to the car service division of the American Railway Association to get the relation of cars manufactured in the first four months of each year as against the total for a year. I based it on experience, and estimated the actual production of this company for the entire year.

Senator COUZENS. Then this memorandum here shows a cleaning up of the tax year of 1918?

Mr. TANDROW. Yes, sir.

Senator COUZENS. 1919?

Mr. TANDROW. 1919 and 1920.

Senator COUZENS. And 1920?

Mr. TANDROW. Yes.

Senator COUZENS. For three years?

Mr. TANDROW. Yes, sir.

Senator COUZENS. And for 1921 and 1922 they are not cleaned up yet?

Mr. TANDROW. I do not believe so. I do not believe effect has been given to any amortization in 1921. It was spread in the years 1918, 1919, and 1920.

Senator COUZENS. On this memorandum you say here:

Letter from consolidated returns subdivision through Mr. S. T. De La Mater.

These are memoranda from one section to another section within the bureau, are they?

Mr. TANDROW. Yes; referring to various matters.

The CHAIRMAN. Now, let us find out the date when the first claim for amortization was filed, the amount of it, and what disposition was made of it.

Mr. TANDROW. The first claim was filed with the return filed on June 14, 1919. As I stated before, $1,220,047.45 was deducted on the taxpayer's return.

The CHAIRMAN. That is what the taxpayer claimed?

Mr. TANDROW. That is what the taxpayer claimed.

The CHAIRMAN. Then what was done with that?

Mr. TANDROW. Nothing was done with that.

On May 15, 1920, an amended return for the year 1918, was filed, claiming amortization in the sum of $1,220,047.45.

The CHAIRMAN. How did there happen to be an amended return filed when nothing had been done on the first one that was filed?

Mr. TANDROW. You must understand that these deductions are taken on the tax return, and at the time the original return was filed there may be some auditing features or accounting features that were not cleaned up, so that the amended return would probably not alter the amortization.

The CHAIRMAN. What was the difference there?

Mr. TANDROW. The figures are exactly the same as on the original return.

Senator COUZENS. Just why would they make an amended return if the figures are the same?

Mr. TANDROW. I am speaking now in reference to amortization. The amortization is exactly the same, but on the return there might have been some other figures which would be different on the later return as against their first return.

Senator COUZENS. That is just what we want to know. We are not going into this case looking for amortization, but the whole return. Why was the amended return made?

Mr. TANDROW. I am sorry I can not tell you that, because I only handle the amortization. We have the returns here.

Mr. HARTSON. We have the auditor here. I think Mr. Leary can tell you the reason that they filed the amended return. It made no difference in the claim for amortization.

Mr. TANDROW. No. I should say in the majority of corporate cases amended returns are filed.

Senator COUZENS. I understand that, but what I want to know is the reason for it.

Mr. TANDROW. I am sure I could not tell you.

Senator COUZENS. While he is going on with this, will somebody look that up?

The CHAIRMAN. What was done with that amended return?

Mr. TANDROW. Well, it was assigned for field investigation; that is, so far as the amortization claim was concerned, by a memorandum from the chief of the section.

On September 24, 1921, an engineer visited the plant of the taxpayer.

The CHAIRMAN. What is the name of that engineer?

Mr. TANDROW. Mr. Kahn.

He visited the plant of the taxpayer on September 24, 1921, and he wired to the chief of the section, Mr. De La Mater, that the taxpayers' schedules were so incomplete that it would not be possible to make an examination of the claim, and suggested that they

be advised to amplify the information supporting their claim for amortization. They did that and——

The CHAIRMAN. That is, they filed——

Mr. TANDROW. Yes; they filed new schedules.

The CHAIRMAN (continuing). A more complete return, then?

Mr. TANDROW. They filed a more complete return.

The CHAIRMAN. When?

Mr. TANDROW. I do not know. I have not the date.

Mr. HARTSON. That was not a return, was it? Those were additional schedules.

Mr. TANDROW. Those were additional schedules in support of the amortization.

The CHAIRMAN. Supplementing the original return?

Mr. HARTSON. Yes.

The CHAIRMAN. And supplying what they had omitted before?

Mr. HARTSON. Yes.

Mr. TANDROW. And, as I say, that was assigned for field investigation on December 14, 1921, to Engineers W. H. Cully and M. B. Goss.

Then, on December 19, 1921, the assignment was withdrawn.

Senator COUZENS. Why?

Mr. TANDROW. I have not the explanation—possibly because the amended schedules were not in proper form. I see a reference to a latter here.

Senator COUZENS. You will remember, Mr. Chairman, the Cully was the man who submitted the information that this is a Mellon company, and there was to be no additional assessment made.

I understand that in this case the assignment was withdrawn; is that correct?

Mr. TANDROW. Yes; the assignment was withdrawn, but as I remember the details, that was because the taxpayer had not submitted suitable schedules, showing that an examination could be made. That was the only reason for the withdrawal of it.

Mr. HARTSON. There was not any substitution of other engineers, was there?

Mr. TANDROW. No. Assignments were just made at random.

Mr. HARTSON. In other words, the objection was not because of the persons assigned to the investigation?

Mr. TANDROW. No.

Mr. HARTSON. But it was a criticism because the investigation at that time was not deemed necessary, due to the fact that the information had not come in in sufficient quantity.

The CHAIRMAN. When were they assigned, and when were they withdrawn?

Mr. TANDROW. On December 14, 1921, the assignment was made, and on December 19, 1921, it was withdrawn.

The CHAIRMAN. Five days afterwards; is that right?

Mr. TANDROW. Yes; that is correct. Complete schedules were filed on May 3, 1923, and on May 13, 1923, the case was——

The CHAIRMAN. What happened between December, 1921, and May, 1923? What was going on in the meantime?

Mr. TANDROW. There was miscellaneous correspondence passing between the amortization section and the consolidated returns section in regard to the case.

Senator COUZENS. Where is that correspondence?

Mr. TANDROW. That is in the files.

Senator COUZENS. I wish you would get it for us.

The CHAIRMAN. Can you give us the gist or the substance of that correspondence?

Mr. TANDROW. As I recall it, the consolidated returns division was working on the audit of the case, and, of course, in the case of a large corporation, there are a great many matters that must be questioned in an audit, and until the amortization was settled or until the audit was settled, as I read it, it did not appear to be of advantage to go ahead with the examinations of the amortization claim.

The CHAIRMAN. Was any of that correspondence referred to you?

Mr. TANDROW. No.

The CHAIRMAN. And you did not answer any of it?

Mr. TANDROW. No.

The CHAIRMAN. Who did answer it?

Mr. TANDROW. Various section heads.

The CHAIRMAN. Various section heads answered the correspondence?

Mr. TANDROW. I am just speaking from my knowledge of the correspondence. I know nothing about it.

The CHAIRMAN. From December, 1921, until May, 1923, there was correspondence about this case?

Mr. TANDROW. Yes; running correspondence relating to the case.

The CHAIRMAN. Then what happened in May, 1923?

Mr. TANDROW. On May 3, 1923, the taxpayer filed a very comprehensive and complete claim.

On May 13, 1923, the case was assigned, so far as the amortization was concerned, for field investigation.

On June 20——

Senator COUZENS. To whom was it assigned?

Mr. TANDROW. Engineers W. T. Jennings and W. S. Tandrow.

On July 2, 1923, the engineer's report covering the amortization was submitted.

The CHAIRMAN. What was that report?

Mr. TANDROW. Do you mean the text?

The CHAIRMAN. Yes; what was the report made by Jennings and yourself?

Senator COUZENS. You and Jennings did the job?

Mr. TANDROW. No; I did the job.

Senator COUZENS. You said the job was assigned to you and Jennings?

Mr. TANDROW. It was assigned to Mr. Jennings. He was acting as reviewing engineer.

The CHAIRMAN. Then you made a report?

Mr. TANDROW. Yes; we made a field examination and report. Mr. Jennings had practically nothing to do with the case.

The CHAIRMAN. Was he out there with you?

Mr. TANDROW. He made a trip to Pittsburgh with me. He is the senior engineer, quite an elderly man, very experienced in amortization work. He made a trip through the Butler plant, which is a very large plant, and we discussed the case both in particulars and in general. He then returned to Washington and I continued on with the examination on the 13 plants.

Senator COUZENS. You say Mr. Jennings was a competent and experienced engineer?

Mr. TANDROW. In my opinion, he was a competent engineer.

Senator COUZENS. You were not here when the other testimony was offered in connection with Mr. Jennings, were you?

Mr. TANDROW. Well, of course, it is a matter of opinion, you know.

Senator COUZENS. Proceed and tell us what you found out when you made your report later.

Mr. TANDROW. I made a very careful examination. It required four weeks in the field and two weeks to write the report, and it was to my mind, a very difficult case to handle. For this reason, at the outset, I felt that the taxpayer had not claimed as much, probably, as they could have claimed, and I naturally fought the field investigation. I had considerable trouble. My attitude was this, that I felt if I was at all conciliatory, it might let them feel that they had gotten the allowance very easily, that they could come back and claim more; so I opposed them all I possibly could, hoping that when my report was made they would be perfectly satisfied, and would not come in and request a redetermination and ask for more amortization. It was very obvious to me at the outset that they could have submitted a much larger claim.

The CHAIRMAN. For amortization?

Mr. TANDROW. Yes.

Senator COUZENS. Just what was the difference between their claim and your findings or conclusions?

Mr. TANDROW. About $31,000.

Senator COUZENS. In other words, according to this memorandum here, on the last sheet, all of their claims for amortization were allowed, with the exception of $31,687.80.

Mr. TANDROW. Yes, sir.

The CHAIRMAN. How much did they claim, and how much was allowed?

Mr. TANDROW. They claimed $3,071,451.14, and they were allowed $3,039,763. 34.

Doctor ADAMS. On an investment cost of how much?

Mr. TANDROW. On an investment cost of $4,942,151.80.

The CHAIRMAN. What was the basis of the claim?

Senator COUZENS. Just a minute. That is not according to the report that you have here. The cost as set out here was $4,915,714.69.

Mr. TANDROW. $4,915,000?

Senator COUZENS. Yes.

Mr. TANDROW. I am reading from my report. Of course, this may be wrong. That is not correct, Senator, because I have my report here, and I am reading you the exact figure.

Senator COUZENS. Anyway, there were allowed approximately three-fifths of the cost?

Mr. TANDROW. Approximately three-fifths of the cost.

The CHAIRMAN. What was the basis of their claim? Let us get at that and see what they claimed and what they put it on.

Mr. TANDROW. They claimed largely on the basis of lowered value in use. That is to say, during the war period, they installed facilities that were used in the production of articles contributing to the prosecution of the war, and during that period of maximum operation

they established a proven capacity. Now, as you have been told, in determining amortization, you measure the post-war operations by taking the average of the years 1921, 1922, and 1923, to compare with the proven capacity, to establish value in use. Now, that value in use must not be lower than the sale or salvage value of the property.

In this particular case, their value in use during the postwar period was very nearly 40 per cent. It was slightly less than 40 per cent, and they stated their claim on the basis of sale or salvage value; that is to say, if they would break down the component parts that were added to the plant during the war for production of cars, etc., under Government contract, they would not realize more than 40 per cent of the cost, and in my report I accepted that.

The CHAIRMAN. Could they sell it as a unit?

Mr. TANDROW. Well, the only measure you would have to find the unit value would be the market value of the stock—making a stock and bond valuation of the property, and, of course, on a capitalization basis, it would be less than 40 per cent.

Doctor ADAMS. Do you usually take a breakdown cost for such purposes? Do you not use the term "break-down"?

Mr. TANDROW. No; I would not say that that would prevail.

Doctor ADAMS. Do you think it justifiable to take a sort of dismembered cost for that purpose?

Mr. TANDROW. It would all depend upon the nature of the industry. If you were dealing with a plant that was exclusively engaged in the manufacture, for example, of shells, and that plant had no utility value for any other purpose, without being converted at great expense to salvage, then you would have a breakdown cost; but if the property was retained for use in the going business of the taxpayer, and possessed utility value for use during the postwar period, I think you should let the amortized cost retain the utility value.

The CHAIRMAN. How much of this cost was for additional building and how much for additional machinery?

Mr. TANDROW. I have not it assembled in that way. I have the details, if you wish me to read you all the figures.

The CHAIRMAN. I thought maybe you could give it roughly.

Mr. TANDROW. I could not tell you offhand.

The CHAIRMAN. Was that machinery and building valuable for the manufacture of cars? It was car-manufacturing machinery, was it not?

Mr. TANDROW. Yes; very largely. I would say so.

The CHAIRMAN. After the war was over, they could have used it?

Mr. TANDROW. They could have used it.

The CHAIRMAN. But because of the decreased demand for cars and the fact that their contract had been filled, then you figured that they were entitled to that amortization?

Mr. TANDROW. Yes.

The CHAIRMAN. Because there was no demand for the product that that particular factory was making?

Mr. TANDROW. That is it.

The CHAIRMAN. And because those facilities were not required to meet that demand or any other demand?

Mr. TANDROW. Yes, sir. Of course, I judged the case on the conditions that were known to me before I made the investigation; that is to say, I could not project into the future and render any judgment

on the basis of what I assumed might develop. I just took conditions as they were.

The CHAIRMAN. And you say that during the years 1921 and 1922 it was used only to 40 per cent?

Mr. TANDROW. No; 1921, 1922, and 1923.

The CHAIRMAN. Used to only 40 per cent of its capacity?

Mr. TANDROW. Approximately.

The CHAIRMAN. Why are the years 1919 and 1920 excluded?

Mr. TANDROW. Of course, I can not speak for the department, because I am only an engineer, but there were a great many war contracts that were not canceled immediately following the signing of the armistice and production was continued, and so you do not get a true reflection of the normal condition in taking those years.

The CHAIRMAN. Do you think the three years 1921, 1922, and 1923 give a fair measure of the postwar conditions?

Mr. TANDROW. Yes, sir; because you are limited there, as the law states up to March 3, 1924.

The CHAIRMAN. What prices did you use in getting the estimate on the excess cost?

Mr. TANDROW. I did not reduce this to an excess cost basis, for the reason that it was not submitted on that basis; but I can say, from a very broad experience, that the excess cost on the installations would range around 20 per cent.

The CHAIRMAN. The excess cost over what?

Mr. TANDROW. Over normal post-war replacement costs.

The CHAIRMAN. What, in your opinion, is the normal post-war replacement costs based on what years?

Mr. TANDROW. Well, I would only take the years in which the prices were had for the period of years subsequent to the war period.

The CHAIRMAN. That is to say, from 1921 to 1923, inclusive?

Mr. TANDROW. Yes.

The CHAIRMAN. You would take the average of those years?

Mr. TANDROW. I would take the average of those years. However, I do not believe that a normal post-war period has yet become apparent.

The CHAIRMAN. Well, but the known post-war period must be taken for that period prior to March 3, 1924.

Mr. TANDROW. Yes; we are required to do that.

The CHAIRMAN. And your figure on excess cost on that basis is about 20 per cent?

Mr. TANDROW. Yes; I would say that that is the reasonable estimate to cover the excess cost.

The CHAIRMAN. From an excess capacity of 20 per cent to 40 per cent?

Mr. TANDROW. You get down to a very low figure. Then, it would run far below your salvage value. First, you would have to write off 20 per cent to cover your express cost. That would bring it down to a normal cost or normal value, assuming that the facilities were in full use. There you have 80 per cent. During the amortization period the taxpayer does not get depreciation. A conservative allowance for depreciation would be 5 per cent a year. That would bring it down to 70 per cent. You have two years and then you have a lowered value in use equivalent to 60 per cent; so that you would have about 35 per cent.

Senator COUZENS. In other words, this estimate shows that 60 per cent of their investment was allowed through those methods?

Mr. TANDROW. Yes. It is not unusual.

Senator COUZENS. Do you know whether the company got any refund from the War Claims Board?

Mr. TANDROW. They did in their Hammond plant, but they did not again claim amortization on any facilities upon which contractual amortization had been allowed by the War Department. I have had every opportunity to go into that feature, because at the various plants I noticed machines marked "U. S. No.—, Ordnance Department," and I stepped aside, in many cases, and inquired of the various foremen of the plants if those machines were used on ordnance work. I also checked each machine with the machines upon which they were claiming amortization, and I did not find in any case that they had duplicated the machines.

Senator COUZENS. Do you know what claim was allowed by the War Claims Board?

Mr. TANDROW. I think it was in the neighborhood of $1,000,000.

Senator COUZENS. It is not in the record there.

Mr. TANDROW. No; it is not in the record.

Senator COUZENS. So that there was no chance, all through this figuring of amortization, to get credit both ways?

Mr. TANDROW. No; I was very careful about that feature, because it is specifically treated in our regulations.

Senator COUZENS. Have you found that correspondence Hartson?

Mr. HARTSON. Mr. Leary is ready to produce it. Before he does that, I want to ask Mr. Tandrow a question, and that is whether, in the light of his experience as an appraisal engineer in the department, the allowance for amortization to the Standard Steel Car Co was disproportionate to the allowance to similar companies engaged in like business?

Mr. TANDROW. I should say, when the case was first assigned to me, of course, the question came up to me as to whether or not a car company was entitled to amortize its facilities, and I went into every car company case that had claimed amortization, and I say that this claim is very reasonable and lines up very well with allowances made to other car companies. In fact, there is one very large car company that had its entire claim allowed.

Mr. HARTSON. Mr. Leary, have you that correspondence now?

Senator COUZENS. I would like to ask the witness before he leaves the stand, this question:

Did you see in any of that correspondence that passed between one unit or one section and another, that this was for a Mellon company, and that the case was to be expedited?

Mr. TANDROW. Yes, sir; I did. The case was assigned to me, of course, like any other case is, and I knew absolutely nothing about the Standard Steel Car Co. One of the engineers came over and showed me this letter. He told me that he had been employed by the Standard Steel Car Co. in Hammond, and he argued against them very strongly, and claimed that I had better make a very careful examination of the claim, which I usually do in handling all claims. He carried on a little campaign with me for several days against the company, which, of course, I gave no weight, because it was not material to the determination. I saw the correspondence though.

Senator COUZENS. What was the correspondence that you saw?

Mr. TANDROW. It is in that file. Do you wish to see it?

Senator COUZENS. Well, I wish you would tell us it as you remember it.

Mr. TANDROW. In substance, it stated—there was a deletion. That was the first thing that caught my attention.

Senator COUZENS. A deletion of what?

Mr. TANDROW. From the text of the memorandum. A section of it had been stricken out, with a blue pencil, and I could not make out the words; but, in substance, it said action was being deferred on the investigation of the amortization claim, for the reason that—now, I just can't get the sense; in fact, it did not——

Mr. HARTSON. I do not think his recollection should be imposed upon there.

Mr. TANDROW. No; I would not like to go on record——

The CHAIRMAN. Yes; the letter is the best evidence, Senator.

Senator COUZENS. I have no objection to that, but I just asked him if he recalled the correspondence that I put in the record the other day.

Mr. TANDROW. Yes. Before I ever looked at the taxpayer's schedules this engineer came around with this correspondence and told me that somebody tried to bring some pressure to bear to get the claim through.

Mr. HARTSON. Who was this engineer?

Mr. TANDROW. Mr. Cully.

Mr. HARTSON. I would like to have you state what he told you.

Mr. TANDROW. He told me that he had worked for the Standard Steel Car Co. in Hammond, Ind.

Mr. HARTSON. Before he came into the service?

Mr. TANDROW. Yes, sir; before he came into the service.

Mr. HARTSON. At that time he was an employee of the Bureau of Internal Revenue?

Mr. TANDROW. Yes, sir; and he had found them to be "a bunch of crooks." Those were his words, and when I was making the investigation of the amortization claim I had better be very careful to go into all details and particulars to see that nothing was admitted to amortization that they were not entitled to. He took several opportunities to express his opinion of the company to me. Well. I was perfectly open minded about his suggestion, and I, in fact, did give it some weight, because I did go into the claim very carefully.

Mr. HARTSON. Did he make any statement to you about taking records from the files?

Mr. TANDROW. Yes; he had this little memorandum in a personal file.

Mr. HARTSON. What memorandum have you reference to now?

Mr. TANDROW. That was the basis of his statements to me.

Mr. HARTSON. Did he have the original, or did he have a copy?

Mr. TANDROW. No; he had the original.

Mr. HARTSON. That was separated, then, from the files in the case?

Mr. TANDROW. Yes; that was separated from the files in the case, in a personal file that he had in his desk.

Senator COUZENS. I would like to know how the witness recalls all of this correspondence, and yet he can not tell us what it is.

Mr. HARTSON. He is starting to tell you what it is, Senator.

Mr. TANDROW. I can not quote it verbatim to you.

Senator COUZENS. What was the substance of it?

Mr. TANDROW. The principal reason why I do not remember it is this, that it related to an auditing matter. Now, I am an engineer; I handle amortization, and my interest only goes to questions bearing upon amortization; so that I read the memorandum and paid no more attention to it.

Senator COUZENS. What do you remember of it, as you read it?

Mr. TANDROW. Well, chiefly that some one was trying or had tried in the past to bring pressure to get this case promptly handled. I absolutely disregarded it, because it meant nothing to me.

Senator COUZENS. I am not asking you that, and I wish you would stick to the question. Do you remember just what the correspondence stated?

Mr. TANDROW. The text of it?

Senator COUZENS. What was the substance of it? Whether you have the text or not is not important. What impression did you get from the correspondence?

Mr. TANDROW. That the consolidated section wished to have the final handling of the amortization disposed of, in order that the case might be closed out. That is my recollection. I may be wrong. The memorandum is in the files.

Senator COUZENS. Have you got those files here?

Mr. HARTSON. Senator, you interrupted the witness in regard to his statement about Mr. Cully's reference to taking something from the files. I would like to have the witness continue on that. I do not know what it is he had in mind.

Mr. TANDROW. Well, he had this memorandum with the initials of the acting chief of section on it, in his personal file.

Mr. HARTSON. Had he had this Standard Steel Car Co. case assigned to him?

Mr. TANDROW. He had this Standard Steel Car Co. case assigned to him previously, and it was withdrawn.

Mr. HARTSON. He has extracted, then, from the files this original memorandum which has been discussed?

Mr. TANDROW. In respect to that, I would not like to say that he had taken it.

Mr. HARTSON. He had it in his personal file, had he not?

Mr. TANDROW. He had it in his personal file, but I have not a clear enough recollection of all the papers to say that it was his personal file. It might have been a part of the file of the Standard Steel Car Co.

Mr. HARTSON. I would like to have this in the record: Did Mr. Cully make any statement to you about taking the original of copies of this correspondence, about which there has been testimony, from the files?

Mr. TANDROW. Well, I asked him what he was doing with it. I have a distinct recollection of inquiring why he was holding that correspondence.

Mr. HARTSON. What did he say?

Mr. TANDROW. He told me that, in many cases, employees had been boosted out of the section, and that if he had any trouble, he was going to hold that and use it against them.

Mr. HARTSON. One other question, Mr. Tandrow: When did you have this conversation and see this correspondence? Look at it and tell us as nearly as you can in reference to the time.

Mr. TANDROW. About the 7th of May or the 8th of May.

Mr. HARTSON. Of what year?

Mr. TANDROW. Last year, 1923—just a few days before I went into the field examination.

Mr. HARTSON. At the time you saw it about a year ago, there was this deletion on the face of the memorandum which you have referred to?

Mr. TANDROW. Yes; there was this deletion. That is the point that Mr. Cully called my attention to. He held it up to the light, so that I could get the words that were deleted.

STATEMENT OF MR. FRANK R. LEARY, CHIEF, SECTION A, CONSOLIDATED RETURNS DIVISION, INTERNAL REVENUE BUREAU

The CHAIRMAN. What is your name?

Mr. LEARY. Frank R. Leary, Senator.

The CHAIRMAN. Are you in the employ of the bureau at this time?

Mr. LEARY. Yes, sir.

The CHAIRMAN. How long have you been?

Mr. LEARY. Five years.

The CHAIRMAN. What particular division?

Mr. LEARY. I am chief of section A, consolidated returns division.

The CHAIRMAN. How long have you been in that position?

Mr. LEARY. I have been in there for three years, a little bit longer, I guess.

The CHAIRMAN. What did you do before that?

Mr. LEARY. I was an assistant chief in the same division.

The CHAIRMAN. Are you under civil service?

Mr. LEARY. Yes, sir.

The CHAIRMAN. You are familiar with this Standard Steel Car Co. case, are you?

Mr. LEARY. Yes, sir.

The CHAIRMAN. Now, Senator, do you want to ask him about this?

Senator COUZENS. I was just wondering what he was to testify to. Is it about these letters?

Mr. HARTSON. Mr. Leary is chief of the section that had charge of the audit in this matter about a year ago; is not that correct?

Mr. LEARY. Yes, sir.

Senator COUZENS. This correspondence as I understand it, goes back, because I notice that there are some letters here of 1923, and they go back to 1921.

Mr. LEARY. They do not file those in chronological order, Senator. Sometimes they take different files, and I try to make the men, as far as possible, put tabs on them, so that they become a permanent part of the file, or else they are liable to be torn out.

The CHAIRMAN. When was your attention first called to this particular case?

Mr. LEARY. Some time during the summer of 1923.

The CHAIRMAN. You were not familiar, then, with any of the preceding steps up to that time?

Mr. LEARY. No, sir; I was not.

The CHAIRMAN. Before Mr. Tandrow had made this visit?

Mr. LEARY. Well, I had in this way, that I knew that it was in the division, and that the auditor who had it assigned to him for audit could not, from the report that was submitted by the examining officers, make an audit of it.

The CHAIRMAN. Why?

Mr. LEARY. Well, the first reason was that there were a number of things in the report that he admitted himself that it was not possible for the department to substantiate; that is, in making a decision.

The CHAIRMAN. Who was that man?

Mr. LEARY. I think there were two men making that examination—McCann and somebody else.

The CHAIRMAN. When was it assigned to them?

Mr. TANDROW. I just made a memorandum of that, Senator.

The CHAIRMAN. Yes.

Mr. LEARY. But as near as I can recollect it was sometime in 1921 that McCann made his examination.

Mr. HARTSON. Was he an engineer making an appraisal for amortization purposes?

Mr. LEARY. No, sir; he was an auditor.

Mr. HARTSON. He was an auditor?

Mr. LEARY. He was a traveling auditor.

The CHAIRMAN. Did he make a personal visit to the works?

Mr. LEARY. He did; yes, sir.

The CHAIRMAN. And then afterwards made a report?

Mr. LEARY. Yes, sir.

The CHAIRMAN. And that report, then, was afterwards cast aside, was it?

Mr. LEARY. Well, it was not cast aside, Senator. We saw, in looking over the schedules attached to it, that he stated that it could not possibly be used; that is to say that he made several adjustments that were obviously incorrect. It was the best he could do under the circumstances apparently, and took that viewpoint, to put it down that way and practically leave it up in the air for us to decide about it.

The CHAIRMAN. Is that man in the department now?

Mr. LEARY. I do not believe he is; no, sir.

The CHAIRMAN. Was this case called to your attention at that particular time?

Mr. LEARY. No, sir; it was not.

The CHAIRMAN. Who was it that made the decision that this report was not in all respects justified by the facts?

Mr. LEARY. Well, I could not say who made the decision, Senator.

The CHAIRMAN. Then, somebody else was sent out, and these other reports followed?

Mr. LEARY. Yes, sir.

The CHAIRMAN. You were not familiar with the correspondence at the time it was being had, between December of 1921 and May of 1923?

Mr. LEARY. No, sir; except up to the time that I personally ordered the last examination on it.

The CHAIRMAN. When did that occur?

Mr. LEARY. That occurred in, I think it was, May, 1923.

The CHAIRMAN. Did it come to you in the regular course, or was it specially handed to you?

Mr. LEARY. It came to me in the regular course.

The CHAIRMAN. Just like all other cases similarly situated?

Mr. LEARY. Yes.

The CHAIRMAN. In your section?

Mr. LEARY. Yes, sir.

The CHAIRMAN. And when it came to you, what did you do with it?

Mr. LEARY. I assigned it to a man by the name of Putnam, and told him I would like him to go through it and prepare a memorandum, so that it could be intelligently handled by some man other than himself, who would be able to take advantage of the things he saw in the papers and make that the subject of a memorandum, so it would be comprehensive to somebody that would not have the papers available to him, and I sent that to the head of the division or the subdivision at that time.

The CHAIRMAN. Who was that?

Mr. LEARY. Mr. Bird.

The CHAIRMAN. Then what happened?

Mr. LEARY. He, in turn, approved my recommendation on it (that it be reexamined) and it was turned over to the chief of the traveling unit.

The CHAIRMAN. Who was he?

Mr. LEARY. His name is Lang.

The CHAIRMAN. What did he do?

Mr. LEARY. I believe he held it for about possibly two or three weeks before he had a man available whom he could send out there.

The CHAIRMAN. Whom did he send out?

Mr. LEARY. He sent Mr. Jay O'Brien, I think his name is, and Mr. Frank Murren.

The CHAIRMAN. The two men together?

Mr. LEARY. Yes.

The CHAIRMAN. Did they make a report?

Mr. LEARY. Yes, sir.

The CHAIRMAN. After a personal visit?

Mr. HARTSON. Senator, bear in mind that Mr. Leary is with the auditing branch of the bureau, and this field investigation had reference to a field audit.

The CHAIRMAN. All of which I do have in mind. I was just wondering whether these men were on the ground personally.

Mr. LEARY. Oh, yes: they were there personally. They visited the plant.

Doctor ADAMS. Are these men still in the service?

Mr. LEARY. Yes.

The CHAIRMAN. They are in the service yet?

Mr. LEARY. Yes.

The CHAIRMAN. When they came back, did they make a report?

Mr. LEARY. Yes.

The CHAIRMAN. To whom did they make that report?

Mr. LEARY. They make their report to the commissioner.

The CHAIRMAN. Then, when, in regular order, and in due course, did they come into your hands?

Mr. LEARY. I think they completed the report sometime in the early part of 1923.

The CHAIRMAN. In May, was it, or along in there?

Mr. LEARY. I think it was finished in April, Senator. I think I got it in May.

The CHAIRMAN. When you got it, what did you do with it?

Mr. LEARY. I immediately assigned it to an auditor in that section.

The CHAIRMAN. Did you personally go over it at any time?

Mr. LEARY. I always keep in touch with every one of those cases.

The CHAIRMAN. I know, but in this particular case, did you go over it yourself?

Mr. LEARY. Only in so far as one or two items are concerned.

The CHAIRMAN. By the time it reached you, with all of these various reports, you were satisfied as to the truthfulness and authenticity of the statements made and the substantial basis upon which the amortization was allowed and everything connected with it?

Mr. LEARY. Well, I did not go into the amortization feature of it.

The CHAIRMAN. You did not go into that?

Mr. LEARY. No, sir; I did not. All I was interested in was the allocation of the amount that the engineer allowed in computing the tax.

The CHAIRMAN. Up to that time, had you seen this letter that is talked about here?

Mr. LEARY. No, sir; I only saw that here a week ago, I guess.

The CHAIRMAN. You never at any time during the progress of this matter had heard that this was a Mellon case, and should be expedited, or something done with it?

Mr. LEARY. No, sir; I never heard of it until this investigation.

The CHAIRMAN. All right, Senator.

Senator COUZENS. Did you say you have never seen this correspondence?

Mr. LEARY. Yes. I have seen the correspondence.

Senator COUZENS. When?

Mr. LEARY. About a week ago. You are referring now to that memorandum?

Senator COUZENS. This file of correspondence which you have passed over here to me.

Mr. LEARY. Yes, sir.

Senator COUZENS. You have seen all of this correspondence?

Mr. LEARY. Yes, sir.

The CHAIRMAN. You have not read all of this and all of that [indicating].

Mr. LEARY. Well, I picked it out at random. I picked out some of the correspondence, so that I could hit the high spots.

Senator COUZENS. In the letter that I read into the record, which was handed to me by Mr. Culley, and which was claimed to be the original copy, there was deletion, as appears in the files. In this letter in the files dated December 9, 1921, with reference number 4175, memorandum to Mr. B. L. Wheeler, Chief of Engineers, in re Standard Steel Car Co., Butler, Pa., it says:

> With reference to the case of the above taxpayer, I am now told by Mr. Bird, chief of consolidated returns subdivision, that several of his auditors are engaged in the above case.

Then, I wish to draw the attention of the committee to the fact that it has a blue pencil drawn through a part, after a period. Evi-

dently it was intended that a new sentence be started, in blue pencil mark:

It is requested that information necessary be compiled as quickly as possible

The part which is deleted is the part which we read into the record previously as to its being a Mellon company. At this time, I am asking why is this deleted.

The CHAIRMAN. Do you remember the exact language, the deleted language?

Senator COUZENS. I do not remember it, no. It is in the record here, but I can not quite see it here. It is too well deleted to read it.

Mr. HARTSON. I have no explanation to offer at this time as to why that was done. Mr. Tandrow, the man who was just on the stand, testified that that deletion was there when the original was shown to him by Mr. Culley, the man who furnished you with a copy, or the purported written original of this same memorandum, and who, while he was in the employ of the service, told Mr. Tandrow that he was going to save a copy for use, in case he were ever put out.

Now, we can call, and I think the committee should call, Mr. Kischpaugh, the man who signed the original memorandum, and also call Mr. De La Mater, who was then chief of the amortization section. Both of those men should have knowledge of that.

The CHAIRMAN. If you will give Senator Couzens the names we will have them subpœnaed.

Senator COUZENS. De La Mater is not in the service now?

Mr. HARTSON. No; neither of them are in the service now.

Doctor ADAMS. Mr. De La Mater is in town. Is Mr. Kischpaugh?

Mr. LEARY. I do not know.

Mr. NASH. Mr. Kischpaugh is in Philadelphia.

Senator COUZENS. Does anybody know his address?

Mr. NASH. I do not know his address.

Senator COUZENS. Please get it, and we will subpœna him.

Then, you do not know that these memoranda had any influence on the case?

Mr. LEARY. No, sir.

Mr. HARTSON. Well, you know that they did not have an influence on you, do you not?

Mr. LEARY. I know this, that I did not see them until the other day.

The CHAIRMAN. He said he did not know of them until about a week ago.

Senator COUZENS. Were you in charge of the audit of the case?

Mr. LEARY. Yes.

The CHAIRMAN. In order to get this in my mind, you signed it as the man who had charge of the audit of that particular case?

Mr. LEARY. Yes, sir.

The CHAIRMAN. And then afterwards, what happened to it; what became of it?

Mr. LEARY. After I assigned it to him, I believe he worked quite awhile on it.

The CHAIRMAN. Who?

Mr. LEARY. This man, the auditor that I assigned it to. His name was Pike.

The CHAIRMAN. Pike; yes.

Mr. LEARY. I can not estimate the time, but I should say it took him probably five or six weeks, I guess.

The CHAIRMAN. Then what?

Mr. LEARY. In working it up, he prepared what we call in the unit an assessment letter. This letter, generally speaking, makes certain changes in the income, one way or the other; that is, from either the books, or the returns, or whatever basis may be, and it gives our reasons for making such disallowances or such additions as we see the regulations provide, both to invested capital and income. It likewise follows that after getting these figures, which are merely matters of principle, we reduce them to a computation, and those letters were prepared during, I believe, July, 1923. Now, when I speak of July, 1923, I mean that they had been typed up into shape.

Doctor ADAMS. How long did it take to type it, in a case of that sort, Mr. Leary?

Mr. LEARY. I would say in this particular case, Doctor, giving due consideration to the volume of the work at that time, it probably took a typist 10 days to do it.

The CHAIRMAN. Then when you finally sign it, you turn it over to whom?

Mr. LEARY. After I approve it, it goes along to the review section.

The CHAIRMAN. Do you know that that happened in this case?

Mr. LEARY. I do; yes, sir.

The CHAIRMAN. How long did the review section have it, and what did they do with it?

Mr. LEARY. Well, I must say that I can not answer that question.

The CHAIRMAN. Because you did not keep track of this particular case?

Mr. LEARY. No, sir.

Mr. HARTSON. What did they do with this case?

Mr. LEARY. Generally speaking, the procedure is that as soon as they get it from us, they assign it to a man in the section.

Mr. HARTSON. What does he do?

Mr. LEARY. He goes through the papers. He gets the letter that we have prepared and he takes up those adjustments that we make. He also checks it against the audit and report of the revenue agent, and if there are any working papers from the attorneys of the company or the accountants for the company, he checks those, and ties them up, if possible. He goes over the adjustment, together with all of the correspondence in the case that may have passed between the unit and the taxpayer.

Doctor ADAMS. Neither your section nor the review section checks the fundamental figures on amortization?

Mr. LEARY. No, sir.

Mr. HARTSON. You take the figures that are given him and work them into the computation?

Mr. LEARY. Yes.

The CHAIRMAN. Have you any idea how many men in the income-tax unit or in the Internal Revenue Service, anywhere along the line, including engineers, auditors, and everybody else, touched this case from the time it was started until it was completed, in some form or other?

Mr. LEARY. I should say that there might have been a hundred.

Senator COUZENS. I would like to ask Mr. Nash this question: In view of the fact that we have had some discussion concerning the closing of these cases under section 1312 of the revenue act of 1921, why is this memorandum in the files dated November 13, 1923, which says:

> The attached letter from the solicitor for the Comptroller General requesting information relating to income and profits tax returns filed by the Standard Steel Car Co., of Pittsburgh, Pa., is referred to you for attention. The records of this office fail to show that an agreement in accordance with section 1312 of the revenue act of 1921 has been entered into by the taxpayer and the Commissioner of Internal Revenue in this case.

That is signed by W. T. Sherwood, head records division.

Mr. HARTSON. I know that the Comptroller General has been interfering with the allowances in some of these cases. I do not know with regard to this particular case; I never heard of this case with reference to the Comptroller General. I assume that that letter would have reference to some objections that may have been raised by the Comptroller General.

Senator COUZENS Are these letters in the files?

Mr. HARTSON. I doubt that the Comptroller General made any record specifically with regard to this Standard Steel Car Co. case. It was his interference in cases generally that prompted the solicitor at the time that these certificates for overassessment came over for review, that our office made some observations with regard to what the Comptroller General would do. I have no personal knowledge of that.

Doctor ADAMS. Has this case been settled under section 1312?

Mr. HARTSON. It has not. I think this memorandum indicated that it had not been.

Senator COUZENS. While you are looking into that, on January 5 of this year, 1924, you wrote a letter to the Standard Steel Car Co., attention of Mr. B. P. Newton, in which you say:

> Reference is made to your income, excess and profits tax returns filed for the years 1909 to 1920, inclusive, and to a recent field investigation of your books and records in connection therewith.
>
> It appears that you have filed a claim in connection with the payments of your tax liability by which several points have arisen which will require a further explanation from you. It is deemed advisable, therefore, that an informal conference should be arranged at the earliest possible moment in order that the question may be definitely decided.
>
> It is anticipated that you will be in position to advise the unit by return mail as to what date will be agreeable to you for conference.
>
> Respectfully,
>
> J. G. BRIGHT,
> *Deputy Commissioner.*
> By F. R. LEARY,
> *Chief of Section.*

What was the purpose of that?

Mr. LEARY. The purpose of that, Senator, as I recall it now, was this matter that you speak of with the Comptroller General.

Senator COUZENS. What was this matter in connection with the Comptroller General?

Mr. LEARY. It seems that there was a letter sent to the unit, which was brought to my attention, that there was some claim filed by the Standard Steel Car Co. I do not remember the details of it, in which

the Comptroller General wanted to know if the company overpaid their taxes. I wrote that letter to try to clear it up, because I did not know the facts in the case, I just wanted to get some idea as to why the Comptroller General was interested in it and also to try to find out where the overpayment took place.

Senator COUZENS. You mean an overpayment by the Treasury to the company?

Mr. LEARY. Yes, sir.

Senator COUZENS. What was the amount of that overpayment?

Mr. LEARY. There was not any overpayment.

Senator COUZENS. There was not any overpayments?

Mr. LEARY. No, sir.

Senator COUZENS. Why did you have to write the company for the records? Did you not have them there?

Mr. LEARY. No; I wanted to know. I saw the letter from the Attorney General.

Senator COUZENS. From the Comptroller General, you mean?

Mr. LEARY. From the Comptroller General. Pardon me. I was rather vague about the thing, and I wanted to know just exactly what it was, because I did not know whether or not it had been overlooked in the audit.

Senator COUZENS. What has happened since you wrote that letter?

Mr. LEARY. I believe—I did not get this directly—that the claim was withdrawn, whatever it was.

Senator COUZENS. Well, who does know?

Mr. LEARY. I haven't any idea. I presume the attorneys for the company.

Mr. HARTSON. I can inform the Senator, but it will take me until to-morrow to get the information.

Senator COUZENS. How did the Comptroller General get in on this?

Mr. HARTSON. The Comptroller General is attempting, and I think quite properly, to see that there are no refunds or over-assessments to taxpayers, when the taxpayer may, on account of some other branch of the Government, owe the Government something, and they are trying to tie that in. We are sort of pioneering with the Comptroller General. We have received letters from the Comptroller General on several cases which are more letters of inquiry than anything else, and certain of our allowances are going over to the Comptroller General for adjustment with regard to records which might be there covering other governmental departments. There is a question of law involved in it, as to whether he has the right to go over these refunds. I do not know that there was any refund in this case.

Senator COUZENS. That is something entirely new?

Mr. NASH. Senator Watson, the Comptroller General has requested us recently to have all of our refund schedules routed through his office before disbursement, and all of our refund schedules are now routed through his office.

Doctor ADAMS. I think I should call the attention of the gentlemen to the fact that at the present time refunds in certain branches of the Bureau of Internal Revenue are not permitted to offset overassessments in other branches. A case of a very strict hardship of that kind has recently come to my attention. An additional tax in the

estate bureau has been called for and collected, when it entailed an offset refund in the Income Tax Bureau, both depending upon precisely the same questions. The man has to pay an additional tax and gets no refund.

Mr. HARTSON. Do you not agree that that is a defect in the law itself?

Doctor ADAMS. Yes; I believe it is. I do not see how you can comply with the wider suggestion of the Comptroller General, and yet leave this particular situation untouched.

Mr. NASH. We have to comply with the suggestion of the Comptroller General, because he insists on it.

Mr. HARTSON. The 1921 revenue act says that these allowances shall not be subject to review by any other administrative officer of the Government. Now, the Comptroller General says that he is not an administrative officer, and although this 1921 act was passed subsequent to the act which created the position which the present Comptroller General fills, he is taking the position that his office is not an administrative office, and that he can pass on these adjustments made in the bureau. But that is a disputed matter now.

Senator COUZENS. That letter was written to the Standard Steel Car Co.?

Mr. LEARY. Yes, sir.

Senator COUZENS. Did you get a conference?

Mr. LEARY. No, sir.

Senator COUZENS. Where is the reply to this communication?

Mr. LEARY. There was not any reply to that, Senator.

Senator COUZENS. They never replied to it at all?

Mr. LEARY. No, sir.

Senator COUZENS. Where is the information that showed that the matter was closed?

Mr. LEARY. This matter?

Senator COUZENS. Yes.

Mr. LEARY. So far as the department is concerned, we are not interested in it.

Senator COUZENS. Well, you seemed to be interested when you wrote him in January last.

Mr. LEARY. Because I got that memorandum. I did not know what the solicitor's office had to do with adjusting the matter of procedure with the Income Tax Unit. That was out of my jurisdiction. I could not question that. I wanted to know about that, and apparently, from what Mr. Hartson said just now, it has been taken up through his office.

Senator COUZENS. But you said a while ago that the matter was closed, and there was not any excess payment, and therefore there was not anything further. How do you know that if you did not know this when you wrote the letter on January 5?

Mr. LEARY. I knew there was no excess payment because at that particular time I had before me the last assessment we made against the company. As a matter of fact, I had the entire administrative record at that time.

Senator COUZENS. Why did you write the letter if you had it all?

Mr. LEARY. I wanted to know what the Comptroller General had in mind when he asked us as to whether or not there was any excess payment when the record showed that there was not any excess payment.

Senator COUZENS. But this letter does not say anything about this. He says:

It appears that you have filed a claim in connection with the payments of your tax liability.

That has nothing to do with the payment by the Standard Steel Car Co. I do not get this straight in my mind yet. When you wrote this letter, you expected something to come out of it, did you not?

Mr. LEARY. I expected to get an explanation of some claim that they had apparently filed with some other department.

Senator COUZENS. Well, did you?

Mr. LEARY. No, sir.

Senator COUZENS. The matter is, then, not closed, as far as you are concerned?

Mr. LEARY. It was, in this way. If they were not interested to explain to me the reason why they made a claim, I was not interested to see that they got it.

Senator COUZENS. So, as long as they paid no attention to your letter, you dropped the matter?

Mr. LEARY. No, sir.

Senator COUZENS. And you have had no information since that time at all?

Mr. LEARY. No, sir; it was not anything to me. We had to tell them something, and I was interested to see that they got it promptly, if such was the case.

Senator COUZENS. So, in your interest to see that they got it back promptly, you wrote the letter, and they ignored it?

Mr. LEARY. Yes, sir.

Senator COUZENS. And it was only suggested by what? What suggested this letter?

Mr. LEARY. This memorandum that you read here of Mr. Sherwood's.

Senator COUZENS. Then, it took from November 13, 1923, to January 5, 1924, to follow up this matter that was sent to Mr. Lohmann, head of the Consolidated Returns Division. How did you get Mr. Lohmann to suggest that you write to the Standard Steel Car Co.?

Mr. LEARY. He is my immediate chief of division, and it was eventually passed along to me to look after it.

Senator COUZENS. So you are satisfied that it was because of this memorandum from Mr. Sherwood, head of the records division, that caused your writing to the Standard Steel Car Co.?

Mr. LEARY. I feel quite sure that that was it, Senator.

Senator COUZENS. It is a very disconnected correspondence.

Mr. LEARY. That is the reason I wrote the letter, Senator.

Mr. HARTSON. I would be glad to run that down and find out just the occasion for the letter, coming out of my office with reference to this case, and referring to the Comptroller General.

Senator COUZENS. Is Mr. Wheeler still in the department, to whom this letter was addressed, regarding the Mellon Co.?

Mr. NASH. Mr. Wheeler is not in the department.

Senator COUZENS. Do you know where he is?

Mr. NASH. He is in New York.

Senator COUZENS. That is the man that we ought to have in connection with that correspondence. Will you try to get me his address also?

Is Mr. Bird still in the department, chief of the consolidated returns division?

Mr. NASH. No, sir.

Senator COUZENS. He is not in the department?

Mr. NASH. No, sir.

Senator COUZENS. Here is the letter signed by you, Mr. Leary, which is addressed to Mr. McLean, dated April 2, 1923, and which says:

Attached herewith are requisitions for returns covering the Standard Steel Car Co. and subsidiaries for 1909 to 1916, inclusive. Mr. Lang intends releasing the traveling audit men. Therefore, may we expect these returns not later than April 3, 1923?

What do you mean by that?

Mr. LEARY. That is a memorandum addressed to the chief of the administration section, who has charge mostly of the files, and I found that there were a number of returns that had been filed by these companies that were not in the files. That was called to my attention in due course, and I had the auditors prepare requisitions for those returns, to which I attached that memorandum, asking him that, inasmuch as those men had finished the explanation, I would like to be in a position to anticipate them by that date, so that we could go ahead.

Senator COUZENS. Who is Mr. Lang?

Mr. LEARY. He is chief of the administration section of that division.

Senator COUZENS. What audit men was he intending to release, and why?

Mr. LEARY. Mr. Lang was intending to release him.

Senator COUZENS. That is what I am talking about.

Mr. LEARY. He was chief of the traveling audit. He has a number of men in his unit who make these examinations, and these men brought the case in in connection with all the papers, and he was intending to release them and put them on another examination.

Senator COUZENS. Mr. Chairman, I would like to suggest that we adjourn, and that if these gentlemen here will bring down this correspondence, say, at half past 1 to-morrow, we will go through it so as not to delay the committee.

The CHAIRMAN. All right.

Mr. HARTSON. Mr. Nash has some additional information that he wishes to present to the committee.

Senator COUZENS. Yes; we asked for some information through Mr. Nash at the last hearing.

Mr. NASH. I was requested yesterday to submit a memorandum showing the dates of appointment and the dates of resignation of the members of the Johnson & Shores partnership, who had formerly been employed in the Bureau of Internal Revenue.

I have a letter from the commissioner to the chairman of the committee, which reads:

APRIL 1, 1924.

Hon. JAMES E. WATSON,
Chairman Special Committee of the United States Senate to Investigate the Bureau of Internal Revenue.

MY DEAR SENATOR: At the request of your committee there was furnished you, under date of March 31, the names of the members of the firm of Johnson & Shores, together with a statement indicating which of the members of the firm have previously been employed in the Internal Revenue Bureau.

The committee in its meeting of March 31 asked that a statement be furnished it indicating the date of appointment and the date of resignation of those members of the firm who were former employees. The information requested follows:

	Date of appointment	Date of resignation
Wayne Johnson	Apr. 10, 1919	Sept. 15, 1920
Lyle T. Alverson	Nov. 3, 1919	Sept. 30, 1920
Fred. R. Angevine	Aug. 16, 1920	Apr. 24, 1922
Carl A. Mapes	Apr. 1, 1920	Dec. 31, 1922

Sincerely yours,

D. H. BLAIR, *Commissioner.*

Mr. NASH. Senator Couzens requested a list of the companies whom we had written asking for waivers of privacy, in order to submit their returns to the investigating committee. We have written to the following companies:

Lee S. Smith & Son Manufacturing Co., Pittsburgh, Pa. (Reply received.)
Colorado Fuel & Iron Co., Denver, Colo.
Lionel Manufacturing Co., New York, N. Y. (Reply received.)
Rub-No-More Co., Fort Wayne, Ind.
Aluminum Co. of America, Pittsburgh, Pa.
Standard Steel Car Co., Butler, Pa.
Berwind-White Coal Mining Co., Philadelphia, Pa. (Reply received.)
Gulf Oil Corporation, Pittsburgh, Pa.
Allen S. Davison Co., Pittsburgh, Pa.

Replies have been received from Lee S. Smith & Sons Manufacturing Co. and the Berwind-White Coal Mining Co., which have already been submitted to the committee.

The replies from the Gulf Oil Corporation, the Aluminum Co. of America, and the Standard Steel Car Co., are in the possession of the Secretary, and he was before another committee of the Senate to-day, and I was unable to get them.

I have a reply from the Lionel Manufacturing Co., in which they have not completely acquiesced in the submission of their case. Their letter reads as follows:

WASHINGTON, D. C., *March 29, 1924.*

COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

Attention Deputy Commissioner J. G. Bright.

SIR: The amortization claim of the Lionel Corporation was recently disallowed by the committee on appeals and review. The decision of the committee in substance is based upon an engineer's report prepared by Mr. J. F. Adams under date of September 14, 1923, stating, among other things, that the taxpayer had been allowed $40,359.41 by the War Department as compensation for increased facilities and equipment.

In view of certain testimony recently given by Engineer Adams, now discharged, before the Senate Committee investigating the Bureau of Internal Revenue, on March 24, 1924, you asked the consent of the corporation to submit its returns and other data supporting its claim to the said committee. Before

acceding to this request, on yesterday I requested that you assign engineers to examine the War Department records for the purpose of verifying Mr. Adams's findings. You granted this request, assigning Mr. J. T. Keenan, Mr. C. B. Newbury, and Mr. F. Furlow to make the investigation. Your investigators found that Mr. Adams's report was incorrect and that the maximum possible amount allowed by the War Department as amortization of the facilities in question was $12,113.76. The corporation spent $55,952.01 for increased facilities, or $43,838.25 more than was allowed by the War Department.

In view of the developments of the reinvestigation of the claim, it is respectfully requested that the recent decision of the committee on appeals and review be recalled and the case submitted to the said committee for reconsideration and allowance of the claim. Since it is clear that this corporation has been done an injustice by the unwarranted Adams's report, and his testimony before the Senate committee, it is requested that this application be given immediate consideration.

Respectfully,

CLAUDE A. HOPE, *Attorney for Taxpayer.*

The CHAIRMAN. That is not in answer to your letter.

Mr. NASH. It is an answer to our letter.

The CHAIRMAN. It is an answer that does not respond.

Mr. NASH. I might say, for the information of the committee, that this attorney came to the office, very indignant that his case had been mentioned by Mr. Adams, and it appears that the bureau and the committee on appeals and review instigated Mr. Adams's report. You will recall this is the case, that Mr. Adams testified that their total investment was $67,000, that the War Department had allowed somewhere around $50,000, and that their claim to the department was around $20,000. If they had been allowed that claim, they would have received $3,000 more in amortization than their entire investment.

Based on the statement of the attorney, Mr. Greenidge sent three of his engineers to investigate the War Department records, and they have verified the statement that the taxpayer makes in his letter, and we have requested the committee on appeals and review to reopen this case, and from the showing that has been made thus far it appears that the company is entitled to their claim.

Senator COUZENS. Where is this company located?

Mr. NASH. Newark, N. J.

Senator COUZENS. But their attorney is here in Washington?

Mr. NASH. That letter was written in Washington on the day that the attorney was here. He came down here.

The CHAIRMAN. Were those figures as given by him correct?

Mr. NASH. In his testimony?

The CHAIRMAN. Yes.

Mr. NASH. I have not checked them up, Senator.

I will say, Senator Couzens, that I left your request for a list of the Secretary's companies with the secretary to Mr. Mellon this morning. Mr. Mellon was not in his office, and I was unable to get the list.

Senator COUZENS. You will try to bring them to-morrow, will you?

Mr. NASH. That is all.

Senator COUZENS. Is that all you have, Mr. Nash?

Mr. NASH. That is all.

Senator COUZENS. All right.

The CHAIRMAN. The committee will adjourn now until to-morrow afternoon at 2 o'clock.

(Whereupon, at 5 o'clock p. m., the committee adjourned until to-morrow, Wednesday, April 2, 1924, at 2 o'clock p. m.)

BUREAU OF INTERNAL REVENUE

WEDNESDAY, APRIL 2, 1924

UNITED STATES SENATE,
SPECIAL COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 2 o'clock p. m., Senator James E. Watson, presiding.

Present: Senators Watson (chairman), King, and Couzens.

Present also: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. N. T. Hartson, Solicitor Internal Revenue Bureau; and Mr. S. M. Greenidge, head engineering division, Internal Revenue Bureau.

Present also: Dr. T. S. Adams, tax expert, Yale University.

Senator COUZENS. The chairman and the other members of the committee are now engaged in other work. They have requested me to proceed with the hearing at this time, and have advised me that they would get here as soon as they possibly could.

TESTIMONY OF MR. A. C. ERNST, OF ERNST & ERNST, CLEVELAND, OHIO—Resumed

Senator COUZENS. Mr. Ernst was requested to come back here to-day largely at the suggestion of Senator King. Senator King advises me that he has been unable as yet to read the record, and has not prepared any particular questions which he desires to ask Mr. Ernst; but in going over some of the records and hearing the testimony since Mr. Ernst was here previously, some questions have suggested themselves to me. I think that, when we have finished with those matters, we will be able to excuse Mr. Ernst for the time being at least. In case we need him further, he will be later advised.

In the testimony that you gave here previously, Mr. Ernst, you referred to the fact that from 1909, as I recall it, up until 1916 or 1917, you were called in to go over the books for amalgamation purposes and incidental matters involving questions of revising the tax returns. Is that correct?

Mr. ERNST. Substantially. We were called in in connection with a merger. That was late in 1919, and later we took up the tax work, going back to 1909, and filing amended returns.

Senator COUZENS. You testified that you built up the company's records so as to arrive at a new basis from their old so-called antiquated methods of keeping their records and making their returns. Is that correct?

Mr. ERNST. Yes. They had kept their books very conservatively, and I believe I explained to you they had treated various elements

in connection with write-offs, depletion and depreciation in one account, and dealing with the matter as a total at the end of the year.

That involved the making of an analysis of all of the property and capital assets to comply with invested capital, which I spoke of as the "hub of the wheel," in connection with the 1917 law.

Senator COUZENS. When you arrived at this invested capital, did you use the March 1, 1913, values, or did you use the cost?

Mr. ERNST. We used the cost. The law prohibits the using of the March 1, 1913, values as invested capital.

Senator COUZENS. Can you say anything from memory as to wnat the difference was between the invested capital as you built it up, and as it was carried on the books?

Mr. ERNST. My recollection is that our figure of invested capital was less than shown on the books.

Senator COUZENS. Was it the law or the regulations which prescribed the cost rather than the 1913 basis?

Mr. ERNST. Well, the law very clearly gave the taxpayer the right to use the March 1, 1913, basis for depletion purposes, but not as invested capital.

Senator COUZENS. So that you arrived at two sets of figures—one for invested capital and one for depletion?

Mr. ERNST. That is correct. In fact, it was necessary to do so under that law.

Senator COUZENS. The testimony on the part of one of the witnesses since you have been here was to the effect that in arriving at the oil regulations, there were some ninety men, as I recall, who were brought to Washington from all sections of the country to arrive at a set of regulations dealing with oil properties particularly, and perhaps mineral and gas properties as well. Were you among the people who were called here for that purpose?

Mr. ERNST. I was not. I knew that something of that kind had taken place. It was a sort of an advisory group. I had no active part in it, nor did I have an advisory part in it, and was not attached to it in any manner. Neither was any member of my firm.

Senator COUZENS. Did that happen before you took up the Gulf Oil Corporation matter, or afterwards?

Mr. ERNST. I am not sure. We took up the case of the Gulf Oil Corporation about September, 1919. The difficulty, Senator, under the regulations of the 1918 law was great, and there was much pressure for a long time to have rulings and regulations. I knew that on account of this feature of discovery value, there was much planning being done in order to lay out the work of the department to meet that situation. I have no doubt that it was in that connection that they called in the experts.

I also remember very distinctly that the early forms which the department issued, covering geologists' reports and data as to each well and tract, the date, and whether lease or fee, were very materially changed later. That is, taxpayers found themselves in the position of having done a good deal of work, and then having to do it over again. They were learning about the regulations and what had to be done under the law; so that all oil companies—and that applied to minerals as well—were following every move in the department, in order that they might proceed to meet the requirements of the law.

Senator COUZENS. When did it first come to your attention that consideration was being given to allowing depletion to the lessee?

Mr. ERNST. Our work, having started at the end of 1919, was progressing through 1920, and these schedules on all of the wells, of course, were a large feature of that work; that is, it was one part of the return. All matters in reference to the handling of various features dealing with the legal side of the problem were referred to the legal counsel of the Gulf Oil Corporation, Judge Batts. We were advised as to what Judge Batts decided to do, and we followed those instructions. That was more or less continuous on many questions that came up in connection with consolidated returns and many features of intercompany investments, etc.; so that there was practically a continuous relationship there in one form or another. The legal department of the Gulf Oil Corporation was studying the law as to what had to be done, and we were following up the accounting side of the proposition.

Senator COUZENS. You do not remember when you were advised by the legal department of the Gulf Oil Corporation to take credit for depletion on leaseholds, do you?

Mr. ERNST. No; I could not fix a date. I do remember that the decision was very prompt; that is, Judge Batts was very definite about it; that that would be the basis that they would go in on, and the Government examiners were so advised, and they got the details from the schedules.

Senator COUZENS. If I remember correctly, you dealt with no other oil company than the Gulf Oil Corporation. Is that correct?

Mr. ERNST. I modified that to this extent, I believe, that I said, "No other large oil company." We handled a number of oil companies in the southwestern field, as I mentioned, among which were many of these promotion companies. We had been called in in those cases. A large amount of stock had been sold through various brokers, etc. There were some rather bad losses down in the Texas field; but if you have in mind any of the large companies, no—we handled none. The Gulf case was one of the earliest, if not the earliest, large oil company that went through the department.

Senator COUZENS. So that the first time the question of depletion on leaseholds came to your attention was in the Gulf case, then?

Mr. ERNST. Yes, sir. I might say that the same question had been up in connection with a number of mining companies that were clients of mine.

Doctor ADAMS. How did the act treat leaseholds in connection with a mining company?

Mr. ERNST. My firm does no legal work, Doctor. We work with the counsel of the client. They were actively taking it up, and they were watching that mining case that I told you about, which went through the Supreme Court—the Biwahick case. That dealt with depletion.

Doctor ADAMS. Do you happen to recall the attitude of the department toward depletion on leaseholds in the case of solid minerals at that time?

Mr. ERNST. All I know, Doctor, is that the question was under considerable discussion in the department.

Doctor ADAMS. You do not know of any mining company producing solid minerals that claimed depletion on leaseholds, and took it up at that time, do you?

Mr. ERNST. I do know that this is the first large case that did go through, and this went through with the specific reservation, as you know, that went into the A–2 letter; that is, the Government reserved the right in connection with depletion for the lessee. That was a part of this A–2 letter.

Doctor ADAMS. Had the revenue act of 1921 been passed when the A–2 letter was sent out? It had not, had it?

Mr. ERNST. No. I think it had been well matured, however. That is, it was generally understood, through publicity.

Doctor ADAMS. That case was decided in February, 1921?

Mr. ERNST. On February 28, 1921.

Doctor ADAMS. What was the statute of limitations on the 1917 cases, then?

Mr. ERNST. Our case came under this, and there was a provision that said where the question of invested capital adjustments, prior to January 1, 1917, occurred, the right was given to go back and make the adjustment.

Doctor ADAMS. You say the right was reserved in the decision to change the valuations. Now, if the statute of limitations would run in a few months, I do not know that that reservation would amount to much, and I wondered whether the statute of limitations on assessments for 1917 did run. My memory is a little hazy on that. I think it was substantially June, 1921.

Mr. ERNST. As I said, I am not a lawyer. Mr Hartson is here, and he could probably advise us on that; but I do remember that on the point that you raised there was a question of discretion in the Natural Resources Department about the regulations and how taxpayers could be advised to prepare this data. I think it is probably explanatory to say here that there was a large amount of work involved in meeting the requirements of the 1918 law in the filing of schedules. Naturally, the taxpayers were all clamoring to find out how they were to do it.

Doctor ADAMS. My impression is that the statute of limitations at that time was three years after the tax was due. The 1917 tax had been due substantially on June 15, 1918, and that would make the statute of limitations run as of June 15, 1921; but, as I say, my memory is a little treacherous on those points. I am not certain whether that is correct. I am informed that it had been extended by the 1918 act; so that my first statement was not correct.

Senator COUZENS. Did you take credit in making these returns for the cost of dry wells that had been charged off?

Mr. ERNST. If I understand your question, we wrote off dry wells each year.

Senator COUZENS. And they were allowed by the department?

Mr. ERNST. They were.

Senator COUZENS. Do you think that that is a sound theory, Doctor Adams?

Doctor ADAMS. To write off dry wells?

Senator COUZENS. Yes.

Doctor ADAMS. I think, if discovery depletion is allowed, the cost of dry wells should certainly be charged off on a corresponding basis. If one is a capital loss, and one is an allowance, certainly a corresponding loss should be charged against it.

Mr. ERNST. I think that possibly you and I would agree on this, if I may amplify the question, Senator, that the law which laid down the basis of invested capital clearly defined what invested capital should be. Here was money spent on a dry hole; it had no value; it was a loss; it had to be cleared out; it had to be charged off. That was a loss, as there might be a loss of any other venture. There were many different kinds of losses on different business. The amount of depletion credit that came through oil on the discovery value was a credit for income. That was quite aside and had been on an entirely different basis. If you want to go into some detail, and possibly the Doctor has not thought of this point in connection with dry holes, and I merely suggest it, you have the thought in mind that in the natural resources division, in their calculation to get at the total depletion credit, there were various deductions taken. You, Senator, have discussed with me the deduction of 5 per cent, for example, and there were other deductions as to the cost of lifting, drilling, and various expense factors. Now, in that calculation, Doctor Adams, as a deduction from the total depletion credit, there was a factor taken out of that total depletion credit for dry holes.

Doctor ADAMS. I do not exactly understand that, Mr. Ernst, if the Senator will permit you to continue that for a moment. How?

Mr. ERNST. Well, I do not want to be in the position of saying what Mr. Greenidge has done. Is Mr. Greenidge here?

Mr. GREENIDGE. Yes.

Mr. ERNST (addressing Mr. Greenidge). Would you care to amplify that?

Mr. GREENIDGE. No; not unless asked the question directly. I must confess that I did not follow you on it.

Mr. Ernest. Well, see if I agree with what the Government policy is.

Mr. Greenidge made an example here of, we will say, an estimated quantity of oil at $1, using that as the market price. If it was 1,000,000 barrels, it would be $1,000,000 gross credit. Then, from that, you said last week when I was here, that you made various deductions for lifting expenses, etc., and itemizing them. Then you figured in there the element of so many wells and what that would cost as deductible items from the total depletion credit.

Now, so far as the Gulf Oil Corporation was concerned, in our schedules to you, we took as the element of deduction from the total depletion credit an element for the percentage of dry holes. Whether that was done generally I do not know. Ours was the first case going through, and the Gulf Oil Corporation had always conservatively figured those things. They had figured a definite element, Doctor Adams.

Doctor ADAMS. I catch your point now, and it is quite clear to me.

Mr. ERNST. So that our depletion credit had already been reduced by the margin of safety that the Gulf Oil Corporation put in there for dry holes, because they knew that dry holes were an element.

Doctor ADAMS. What you mean is that, starting out with the gross price received for the oil, in order to ascertain a valuation, you must take a deduction for corresponding cost and expenses?

Mr. ERNST. Exactly.

Doctor ADAMS. And among the corresponding costs and expenses were recognized the expenses of dry holes?

Mr. ERNST. Exactly so; and I might add further, for clarification, that the policy of the Gulf Oil Corporation, as I recall it, was that they figured this way, for instance. Take a tract that took eight wells. They figured in one extra for a dry hole, and that total cost of that one extra was taken out of our reserves, and our depletion credit from the Government reduced thereby. Now, to the extent that you have said that you think the dry holes should come out of the depletion credit, I simply wanted you to know what the Gulf policy had been, and the Government people can confirm it that that was the basis of the Gulf Company.

Doctor ADAMS. That contributes to a clearer understanding of it.

Senator COUZENS. Do you remember the names of the employees in this particular unit that you dealt with when you were settling this matter?

Mr. ERNST. All I know, Senator Couzens, is that Mr. Powell was the head of it. So far as my personally dealing with any of them is concerned, I did not. Schedules went in after we had determined the exact form in which they should go in. They were submitted to the Government geologists and experts, and the records thrown open to them.

Senator COUZENS. Do you know whether this 5 per cent basis was used in any other case outside of this?

Mr. ERNST. I never handled any other case, and I have not inquired, Senator. I would like to add this word on the 5 per cent basis—and I have in mind a question you asked last week as to the advantage between the 5 and 10 per cent basis. I think, Doctor Adams, you engaged in that discussion with Mr. Greenidge, and I notice that Mr. Greenidge has submitted some tables which indicate that there would be no advantage to the taxpayer as between the 5 and 10 per cent basis, as I read his tables. That clears up a question that you asked me.

Senator COUZENS. As I understand it, that was proved by the table you produced, Mr. Greenidge. I forgot, but the tables are in the records here somewhere.

Mr. ERNST. I have them here.

Senator COUZENS. While you are looking that up, who were the ex-Treasury employees that assisted you in preparing this table, Mr. Ernst?

Mr. ERNST. Who were the ex-Treasury employees?

Senator COUZENS. Yes.

Mr. ERNST. I do not know of any, offhand, that assisted me.

Senator COUZENS. Were there any of them in your employ or in the employ of the Gulf Oil Corporation that helped you on it?

Mr. ERNST. There were none in my employ; no, sir. If the Gulf Oil Corporation had any in their employ, I did not deal with them.

Senator COUZENS. You had no workings with them?

Mr. ERNST. Not any.

Senator COUZENS. Have you ever employed any former employees of the bureau?

Mr. ERNST. I believe there was one, Senator. I would like to explain that, if I may.

Senator COUZENS. Yes.

Mr. ERNST. If my memory serves me correctly, there was an advisory commission in regard to the 1917 and 1918 law, composed of business men, was there not, Doctor Adams?

Doctor ADAMS. Yes.

Mr. ERNST. And as the secretary of that advisory tax board, there was a J. C. Peacock. Do you happen to recall Mr. Peacock, Doctor Adams?

Doctof ADAMS. Yes.

Mr. ERNST. His work in connection with that board was purely administrative, as I recall it. He handled no tax cases whatever. He came with me in 1919. I believe it was early in 1919, and he stayed a year, and then left to take up the practice of law. He had handled no tax cases for the Government. It was not his line of work. Am I correct in that?

Doctor ADAMS. No; I think you are not correct about that, but you mentioned Mr. Peacock yourself before in your testimony.

Mr. ERNST. Did I?

Doctor ADAMS. You are slightly incorrect about his not handling tax cases.

Mr. ERNST. Well, I remember that he had handled none that we were interested in or had any contact with. I remember that. My impression was that he was purely an administrative secretary for this board, which was working on an amplification of regulations, and so forth.

Senator COUZENS. Do you remember the circumstances under which you employed him?

Mr. ERNST. Yes; I remember it quite well. I looked the ground over to find a man who could keep in touch with new regulation so that we could be advised more accurately than through newspaper reports and this bulleting service. I never knew Mr. Peacock, but he was highly recommended, and I took him.

Senator COUZENS. Where did you locate him to have this inside information, so that you would not have to rely on newspapers?

Mr. ERNST. If I may differ as to the inside information, I think that may be misunderstood. There was no inside information. The Treasury Department had been putting out bulletins and rulings, and it was in order that we might have some one in Washington, immediately that those bulletins came out, who could send them to each of our offices, so that we would be advised in Detroit and wherever we had offices, that he was employed. There was no confidential information from the inside. The law had been passed. This was purely an amplification of regulations through this committee.

Senator COUZENS. When you began to talk about Mr. Peacock, you said you employed Mr. Peacock so that you would not have to rely upon bulletins and newspapers, and afterwards you qualified that statement, so that it appears you did rely upon the bulletins. Is that correct?

Mr. ERNST. Yes; the bulletins were officials. Sometimes there was difficulty in getting them through the mails and in getting an interpretation of them, and we used Mr. Peacock solely for distributing the bulleting service in our own organization. He was with me about a year.

Senator COUZENS. What I have not been able to get clearly in my mind yet from the statement of anybody is how it was that on February 28, 1921, you settled the Gulf Oil Corporation cases and took credit for leasehold depletion, and yet there is no evidence, apparently, that there was any regulation issued by the department deal-

ing with that matter, as applied to 1916 and 1917, until August, 1922. I was just wondering how it was that you were able to get that before any order was promulgated as to 1916 and 1917 returns.

Mr. ERNST. Well, I might say, so as to have it clearly understood, at least by you, Senator, that, so far as I was concerned, I dealt with it purely as one matter of policy among many. We were working in conjunction with the legal department of the Gulf Oil Corporation. I might say to you further that in hundreds of cases, we had a very serious question as to items in affecting invested capital, where the legal counsel for our clients insisted on the returns going in on a basis, with an amplification of the return explaining the facts, counsel stating that they were prepared to go to court on that question.

Now, the legal side was absolutely nothing to me, beyond having the return clearly state the fact, because we all knew then, in practicing before the department, that there were many disputed points between able counsel. In the meantime, these returns had to go in to the Government. They could be delayed a certain time, but you had to go in and make a return and calculate your tax and pay it. In order to get the thing moving and settle it with the Government later, legal counsel would advise me what to do, and the return was made on the basis of their legal opinion, and the return so stated. So that when you particularly question me about the Gulf depletion basis, it was no different than a hundred cases that I could cite you.

For instance, I had many cases where legal counsel insisted on taking as a deduction contributions made by corporations to the war chest, to the Red Cross. They said, "This is a war measure; the Government is back of it; this should be allowed, but the regulations say no. Well, we do not think they are right. We want that deduction made." So attention was called to it.

Now, I think lawyers, Senator Couzens, generally recognize that the 1918 act was far from being a perfect model of a tax bill. It was an act put through under great pressure, with many disagreements. It was a brand new thing, in so far as this invested capital feature was concerned. Then, the 1918 act followed, which was far more drastic as to the 80 per cent, and many new features were incorporated, so that many very able lawyers whom I dealt with simply said, "This is all very nice, but there are going to be some Supreme Court decisions later; we are going to have a chance to be heard."

Senator COUZENS. I would like to ask Mr. Hartson or Mr. Nash, whichever one can answer it, if there is any record anywhere in the department showing the development of the considerations given to this question of lessee depletion for the years 1916 and 1917?

Mr. HARTSON. Yes; I have something on that, Senator.

Senator COUZENS. Can you give it to us?

Mr. HARTSON. Yes.

Senator COUZENS. All right; when we get through with Mr. Ernst, we will take that up.

Mr. HARTSON. All right.

Senator COUZENS. Mr. Ernst, do you know anything about the history of section 1312 of the act, permitting the closing up of these returns?

Mr. ERNST. I know that there is a section 1312, and that the purpose of it is to definitely and finally close the tax cases, which, in principle, Senator, I think is very sound. Many corporations have not availed themselves of section 1312, because of the thought in their minds, and even on the part of their legal counsel, that there would be subsequent decisions, probably through the Supreme Court, that might permit reopening their cases. So that if a corporation signs 1312, it settles it, in spite of any readjustment later in favor of the corporation. I think most corporations have a very distinct belief that for 1917 and 1918 they paid too much tax. I am quoting you this just generally from my own clientile.

Senator COUZENS. Are you still doing work for the Gulf Oil Corporation?

Mr. ERNST. We have done no work since these returns.

Senator COUZENS. You had nothing to do with the filing of the request to close the Gulf Oil Corporation case under Section 1312?

Mr. ERNST. No.

Senator COUZENS. During our discussions while you were away, and I guess probably the day that you were here, there was stated, I think by Mr. Greenidge, that in arriving at the contents of the wells and the basis for depletion, geologists worked on the job to determine the contents of the wells, and that was used as a basis, in addition to the estimates of the taxpayer and the 5 per cent basis. What other element was there that entered into that in arriving at it, besides those two that I have mentioned?

Mr. ERNST. Well, there were a great many elements. If I may say so, there was purely the historical information in the field. Then, there was the question of state of all of the different properties, as to whether fee or leasehold.

Senator COUZENS. Yes; but that did not have anything to do with the contents of the well, whether it was fee or leasehold.

Mr. ERNST. No; but developing of the data, that is, establishing those figures, and whether it was March 1, 1913, or subsequent, etc. There was a vast amount of work that had to be done, not only the field work, but the office work in handling leases and properties, and many legal questions arose as to the different arrangements under different policies, between lessor and lessee, where there was a joint operation, etc.

Senator COUZENS. In considering this case, did you come in contact with Mr. Darnell?

Mr. ERNST. I never did.

Senator COUZENS. Do you know of him?

Mr. ERNST. Yes; I think he is an ex-department employee. I knew that he was doing work for other oil companies, some of the larger companies, I think, but not any that I was associated with. I know that he was very much interested in the basis that was being used by the Gulf Oil Corporation, because he was doing a great deal of field work in this same territory.

Senator COUZENS. Was he in the employ of the department when you say he displayed this interest in the Gulf Oil Corportaion case?

Mr. ERNST. No; I never came in contact with Mr. Darnell during this work, but some of my own men, who were down in the Texas field, getting these records, costs of drilling, and all of that, had come in contact with him down there and said that he had other work that was going on.

Senator COUZENS. Was he in the employ of the Government then?

Mr. ERNST. No; he was then practicing himself.

Senator COUZENS. He was then practicing himself?

Mr. ERNST. Oh, yes. He was down there on work, because some of my own field men said that other oil companies were apparently going through this same process. They would see those men staying at the same hotel there.

Senator COUZENS. Did you come in contact with Wayne Johnson, an attorney in New York, at this time?

Mr. ERNST. No.

Senator COUZENS. Did you ever meet Mr. Johnson?

Mr. ERNST. Yes; he has been in several cases with me, where he represented clients that were my clients on the accounting side.

Senator COUZENS. He represents them on the legal side?

Mr. ERNST. Yes.

Senator COUZENS. And you on the accounting side?

Mr. ERNST. No; I might say, Senator, that our work was completed with the A-2 letter, and so far as anyone advising with me on this case is concerned, there was no one outside of the Gulf Oil Corporation's own representatives.

Senator COUZENS. I think that is all.

Doctor ADAMS. Mr. Ernst, do you recall what division was made between lessors and lessee of the discovery values in this case?

Mr. ERNST. I remember, Doctor, that, as I tried to tell Senator Couzens, there were many different parcels here which had different arrangements, and there was a division there made, whatever the arrangement was, as to the depletion.

Doctor ADAMS. You do not know whether the lessors at that time were given the advantage of discovery depletion on their proportionate share, do you? Do you happen to know that? You might or you might not know it.

Mr. ERNST. I know I had many clients where the lessor came in and was advised of the basis and how much he would take and what the lessee would take, and I know that in other cases letters were written advising them. That, however, was handled in the legal department of the Gulf Oil Corporation, and my memory is that it did not come up to us; that is, our schedules for the Gulf Oil Corporation carried the full information and the portion that the Gulf Co. was entitled to take.

Doctor ADAMS. And at that time, when the discovery valuation was made, you only took such proportionate part as your interest in the property would suggest? I am interested in this because we had some question about the right of the lessor to share in the discovery depletion as compared with the right of the lessee to take it.

Mr. ERNST. That is right.

Doctor ADAMS. And I want to know whether in your case that question had been settled. That is my sole interest in it.

Mr. ERNST. Generally speaking, in mining cases, Doctor, there was a good deal of question between the legal counsel of the lessor and the lessee.

Doctor ADAMS. Well, Mr. Hartson has answered my question satisfactorily, that it had been decided before your case was settled.

Mr. ERNST. Yes.

Senator COUZENS. Do you recall offhand what Treasury Decision 2956 was, of December, 1919, that you referred to when you were here before?

Mr. ERNST. I referred to that Treasury Decision, Senator, as giving exact detailed instructions as to discovery valuation in the final form in which it had to go in and the basis of it, etc.

Senator COUZENS. When you attempted to arrive at this discovery depletion allowance of credit, what period did you use in arriving at the oil value; that is, as to the price per barrel?

Mr. ERNST. The price was fixed according to the market value of the oil at that time; that is, there was a 30-day period of discovery provided. The Government had its own basis there of taking the price, that is, the market price in the different fields.

Senator COUZENS. So when you went back to prepare these returns over again, you went to the market values that existed at the time that these oil wells were discovered?

Mr. ERNST. Of course, the discovery value came in only under the 1918 law, and we fitted in with the Government regulations as to what we had to give them. Those prices in the different fields were pretty well posted and were a matter of public information.

Senator COUZENS. When you were dealing with the Gulf Oil case, I understand that there was a contemplated or actual—I forget which—claim for amortization of some one million a hundred and some odd thousand dollars. Do you recall that case?

Mr. ERNST. Yes; I recall it very distinctly, Senator. The amortization provision was very vague in 1919, and it was still vague in 1920. The engineers were working on the historical data and forms of reports. Engineers were leaving the department; new ones were coming in, and it was very difficult to know just how to meet the amortization provision; because there were no definite rules that had been laid down. I remember that Mr. Roper, the then commissioner, issued some statement in relation to it, and I think one statement was to the effect that the taxpayer would not be permitted, in the 1918 return, to take over 25 per cent of the amount of amortizable property. That is, he just issued some bulletin because it was so vague, saying that all you could take was that much. I remember that he made a restriction.

In connection with the Gulf case, we realized that they had spent a pretty large sum of money during the war period, and there was undoubtedly a large claim in their favor. Just how much it was, we were not in a postion to say. They had made a rough estimate, so as to have something in their return as a protective feature, which was being done generally by most corporations, under legal advice. We started to get the data together. I was satisfied that the claim would be far in excess of what they had put in temporarily, but it meant sending another crew of men through the fields, and a great deal of engineering work. Then, the department finally told me that they would require every voucher, with all the details and all the property earmarked, and so forth, which involved a vast amount of work, and the result was that the Gulf Oil Corporation asked me not to go ahead with it, and I never completed it.

Doctor ADAMS. The amortization claim, then, was in no sense complete?

Mr. ERNST. Oh, no, absolutely not, Doctor.

Senator COUZENS. None was ever made, then?

Mr. ERNST. Yes; a claim was made, just in the same way as any other corporations were doing. I mean that we might put in a flat amount. It was, say, $10,000,000, under the Treasury Department's notice to the taxpayers; we might take a round figure of $2,500,000, and in some cases we have not that settled to-day.

Senator COUZENS. Just what did you take in this case?

Mr. ERNST. As I remember it, the company took only two million dollars and something.

Senator COUZENS. That was rejected, however, was it not?

Mr. ERNST. Yes; they rejected it, because we did not complete all of these elaborate schedules.

Doctor ADAMS. The case was not in a postion to ask you to pass judgment on it.

Mr. ERNST. Yes. In other words——

Senator COUZENS (interposing). Just a minute. Doctor Adams asked you whether the case was in a position to pass judgment on it.

Mr. ERNST. No; we had not complied with the vast amount of detailed data that was requested. The department had many cases, and we were in the same situation, the taxpayers not knowing what to do, or how the department required it, and they had made a deduction, which Mr. Roper's bulletin clearly indicated could be done. Then, the engineering department, in reaching those cases, would request you to comply with their regulations and submit it. That meant in many cases a much larger amount of work, and it came some time after the war had ended and business had gotten more or less to normal. So in this case the taxpayer simply did not comply.

Senator COUZENS. And the tentative amount put in that return was then rejected?

Mr. ERNST. Yes; there was not a cent allowed. It was all thrown out.

Senator COUZENS. So at no time during your auditing of the books was any proper claim filed for amortization?

Mr. ERNST. Well, I would like technically to say this, that when the claim was made, this taxpayer, the Gulf Oil Corporation, did what every other taxpayer did.

Senator COUZENS. Oh, yes; I understand that.

Mr. ERNST. But later on, Senator, a complete schedule, with all of the exhibits, was not filed.

Senator COUZENS. And that was the proper way in which to file a claim, after the regulations came out.

Mr. ERNST. Based upon the final rules promulgated by the amortization section; yes, sir.

Senator COUZENS. Did you ever analyze that to see what it might have been had it been carried through?

Mr. ERNST. I remember discussions on it, and as I recall it, the lowest estimate I made was over $2,000,000. I just have a recollection of that figure.

Senator COUZENS. When arriving at these credits for lessee depletion, can you, offhand, say what the relation would be between the lessor and the lessee as to allowance or credit?

Mr. ERNST. We did not deal, Senator, with the lessee. Where a leasehold was involved, the computation would be made on that particular property, and if the lessor's part of it was one-eighth, what-

ever the arrangement was, the schedule showed, which was filed here in Washington.

Senator COUZENS. So that you do not think there was any opportunity for both the lessor and lessee to be allowed a depletion credit?

Mr. ERNST. I do not see how it could happen, because the Government had the full information.

Senator COUZENS. I think that is all I have, Mr. Ernst.

Doctor ADAMS. I would like to bring out this point that the Senator has just been speaking about, speaking now of lessee depletion on the basis of 1913 values, and not speaking of discovery depletion. It follows that if a depletion is given to a lessee it would have to be withheld from the lessor, does it not?

Mr. ERNST. Well, not as I understand it.

Doctor ADAMS. I really want to know about that.

Mr. ERNST. Because if, in our schedules, we took a given property, and our interest was seven-eighths, the March 1, 1913, value of that property would be checked to establish the fair market value. Our share of the depletion credit based on the March 1, 1913, value would be seven-eighths.

Doctor ADAMS. I am not certain on this point myself and I want to bring it out. The regulations in effect at that time provided that the lessee was not entitled to depletion. That is correct, is it not? I am referring to the printed regulations which were in effect.

Mr. ERNST. Yes.

Doctor ADAMS. Yes. That is, I take it, unquestioned. It is unquestioned, because I note that the circuit court of appeals, in Lych *v.* Alworth-Stephens Co., in a recent decision, upheld the right of lessees to depletion. The regulations provide that lessee oil and gas corporations are entitled to no allowance for depletion; that is, prior to this Decision 3386, of August 22, 1922.

So we can assume, therefore, that the printed regulations did not entitle the lessee to depletion at that time.

Mr. ERNST. Yes.

Doctor ADAMS. Now, somebody was entitled to depletion under the regulations on the 1913 value, is not that correct?

Mr. ERNST. Yes; undoubtedly.

Doctor ADAMS. That somebody must have been the lessor, must it not?

Mr. ERNST. Well, it might have been.

Doctor ADAMS. My sole purpose is to bring this out—and I am not certain of it—that by allowing the depletion to the lessee you take it away from the lessor, and that correspondingly the lessor would be entitled to that amount that had not been granted to the lessee.

Senator COUZENS. I think, Doctor Adams, that Mr. Hartson ought to have that, because he says he has the history of the depletion records here. If it went along to 1921, and the lessor was allowed depletion for 1916 and 1917, and then the rules were changed to allow it to the lessee, it must have been a duplicate allowance, or else the lessor was not allowed it in the first instance.

Mr. ERNST. With regard to the Gulf Oil Corporation, I might add this, that Judge Batts was most positive in his opinion as to the position between the lessor and the lessee, and he had taken this position, that the lessee was entitled to it.

Senator COUZENS. Oh, yes; you testified to that.

Mr. ERNST. Of course, he knew the March 1, 1913, situation, because that had been dealt with.

Senator COUZENS. But we are trying to get at what the department did.

Mr. ERNST. Yes. Of course, I would not and I do not know what the department had or what the record would show as to the general development of that question.

Senator COUZENS. Do you want to ask Mr. Ernst any questions, Mr. Chairman?

The CHAIRMAN. No; I do not know the line of the examination.

Senator COUZENS. We are through with him, then.

The CHAIRMAN. All right.

STATEMENT OF N. T. HARTSON, SOLICITOR, INTERNAL REVENUE BUREAU—Resumed.

Senator COUZENS. Mr. Hartson, while on this depletion question, I would like to have you give us the history of this depletion for lessees?

Mr. HARTSON. While this question is fresh in your minds, the last question that you asked Mr. Ernst in regard to the allowance to lessors during the time when the printed regulations prohibited lessee depletion, let me say that the allowance that was made to lessors during that period was only in proportion to their share of the royalties from the well. In other words, if they had a one-eighth share in the production of the well, the depletion allowance to the lessor was only one-eighth; so that when, later on, the lessees were given it, they took the other seven-eighths. They took nothing from the lessors, when allowed it later on.

Senator COUZENS. In other words, then, the Government saved the depletion credit during the years 1916 and 1917 until they reversed their decision, and gave credit to the lessee?

Mr. HARTSON. I think that is a fair statement of it. The Government got the benefit of it during the interim, when they were not allowing it to the lessees.

Doctor ADAMS. Was the same thing true of mines and solid minerals?

Mr. HARTSON. I think it was the same. I have that here, and I think it applied it to the same length here. I would like to develop that from the beginning, if I may.

Under the special excise tax on corporations in 1909, section 38 of that tax, second paragraph, provided that such net income shall be ascertained by deducting from the gross amount of the income the losses, including a reasonable allowance for depreciation of property, if any.

That provision of law was availed of by owners of mines and oil wells to permit them to take advantage of the so-called depletion; and under two opinions of the Supreme Court that was expressly denied. That depreciation was not similar to depletion for land. This depletion allowance therefore under the 1919 act was not given them——

Senator COUZENS (interposing). The 1919 act, or the 1909 act?

Mr. HARTSON. 1909 act.

In the Biwabik case the Supreme Court held that the lessee of mining property may not deduct the proportionate value of the ore in place on January 1, 1909, with recpect to each ton of ore as so much depletion of capital assets, but may deduct a proportionate part of the royalty paid in advance. I think that answers the Doctor's question with regard to the 1909 act, so far as solid minerals is concerned.

In 1913 the next revenue act, section B of section 2, provides that in computing net income for the purpose of the normal tax there shall be allowed as deductions, sixth:

A reasonable allowance for the exhaustion of property not to exceed in the case of mines 5 per cent of the cost value at the mine of the output for the year for which the computation is made.

The statute, therefore, provides a maximum limitation, but only that that be reasonable, and then says, "not in excess of 5 per cent."

In the Staunton case, that went to the Supreme Court, the contention was that the above allowance was inadequate and the tax was in effect on the gross income rather than on the net income which would not be allowable under the sixteenth amendment. But the court denies the contention, and also justifies the tax as an excise levy on the results of the business of carrying on mining operations.

Now we come to the 1916 act: Section 5, paragraph 8, provides that—

in computing the income in the case of oil and gas wells a reasonable allowance for the actual reduction in flow and production, to be ascertained not by the rush flow but by the settled production, or regular flow; if in the case of mines, a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of A and B under the rules and regulations prescribed by the Secretary of the Treasury; provided that when the allowance is authorized in A and B shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value of that date, no further allowances shall be made.

The above sections granted substantially full depletion to an operating owner or lessor, but the allowance was held not to be available to the lessee prior to the promulgation of law opinion 1103 which permitted depletion to oil lessees under the 1916 act.

Under the 1916 act the commissioner, with the approval of the Secretary, promulgated Regulations 33, revised, and article 170 of those regulations or that portion of it that seems to be material, reads as follows:

Sections 5 and 12 of the act of September 8, again as amended by the act of October 3, 1917, pertaining to individuals and corporations owning and operating gas or oil properties, may deduct from gross income—and this is quoted from the law—

a reasonable allowance for actual reduction in flow and production provided that when the allowance authorized shall equal the capital originally invested, or in the case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made.

That is the close of the quotation from the law. Now, the regulation continues on——

Senator COUZENS (interposing). What law was that?

Mr. HARTSON. The 1916 act as amended by the 1917 act.

Senator COUZENS. A moment ago you referred to some decision eleven hundred and something; what was that?

Mr. HARTSON. Law opinion 1103 is the law opinion which came out in 1922, and which affected the 1916 act and construed the 1916 act and the regulations.

Senator COUZENS. And yet this was a construction, was it, that you were just reading?

Mr. HARTSON. Yes; I am reading now from the regulations which were in effect prior to the promulgation of that law opinion. Do I make myself clear on that?

Senator COUZENS. I am not quite sure that you do. When were those rules promulgated that you just read?

Mr. HARTSON. They were promulgated in 1918, immediately following the enactment of the 1917 act, probably within a month or two after the adoption of the 1917 law.

Senator COUZENS. Then what interpretation do you put on that that you have just read?

Mr. HARTSON. I have just read from the law; and I would like to continue on with the regulations, to give you the background over which this discussion was waged, because there was a tremendous amount of uncertainty and discussion involved over the interpretation of that section of the 1916 and 1917 acts. To read now from the regulations:

The essence of this provision of law is that the owner or operator of this character of properties shall secure through an aggregate of annual depletion deductions the return of the amount of the capital actually invested, or an amount not in excess of the fair market value as of March 1, 1913, of the properties owned prior to that date. For the purpose of determining the amount of capital to be returned through annual deductions operators may be divided into two classes: (A) Operators who owned the fee; and (B) operators who own a lease or leases. Then it goes on and says in the case of the operating fee owner—that is, the owner of the property, owner of the title to the property—the amount returnable through depletion deductions is the fair market value of the property exclusive of the cost of the physical property as of March 1, 1913. Now, that is the value from which this depletion is taken, and there is no way to read beyond that except to go to the next paragraph, which covers lessees.

In the case of a lessee the capital which is to be returned is the amount paid in cash or its equivalent as a bonus, or otherwise, by the lessee for the lease. In other words, so far as the lessee is concerned it is not permitted under these regulations to deplete from a March 1, 1913, basis.

Now, those regulations were in effect——

The CHAIRMAN (interposing). And, of course, you construed that the regulations do not run in contravention to the statute, but conform with the law?

Mr. HARTSON. That is right, but that interpretation by the department of that provision of law was the subject of a very great deal of criticism. It was contended by the oil people immediately upon the promulgation of these regulations construing that clause of the 1916 and 1917 acts that the law permitting a reasonable allowance for the actual reduction in flow and production did not on its face prohibit that to the lessee; that the lessee's interest in the well was substantially greater than the owner of the fee, and that of course is evidenced by the royalty allowance to the fee owner, or it is a small proportion to what the operator and the actual producer gets, and the investment is all the lessee's in cases such as this, as a result of that equities were very strongly in favor of the lessees and their right to deplete or to take the allowance for depletion.

That was the subject of a great deal of discussion, and the history of that must be borne in mind, that during these years that this law was effective the returns were coming in and piling up; there was a state of uncertainty; there was practically no auditing and detailed and accurate checking of the returns of all oil corporations for these years; that it was not until 1919 and 1920 that the criticism got to the point of concrete figures in definite cases.

In 1919 Mr. Ernst has testified regarding the Gulf case. I apprehend, and I think my judgment is correct on this, that that case was the first large case where this definite question was positively raised. There has been a great deal of discussion about it. Mr. Greenidge testified that in his section among the engineers before the regulations were changed affecting those years, the engineers who had to do with this question were all of the opinion that by reason of the equities and by reason of there appearing in the law to be no reasonable distinction between the owner of the fee and the owner of the lease as to the depletion allowances that ultimately the regulations would be changed.

On November 5, 1920, the first record is made in the solicitor's office of a case being sent there for a ruling on this question. That case was the Equality Oil Co. It arrived in the office on November 5, 1920, and came, by the way, from the committee on appeals and review. It was a case that had been appealed to the committee and was forwarded to the solicitor's office for determination of this question of law.

On January 22, 1921, that was two months later, approximately, another case came into the office, and that case was the Britton, Johnson Oil Co.

Senator COUZENS. Just at that point, may I ask what was done with the case that came there November 5?

Mr. HARTSON. Yes; I will tell you very readily: These cases accumulated there subject to a final determination. That case which arrived November 5, 1920, was not ultimately passed on until it went out under the authority of law opinion 1113, a year and a half later.

Senator COUZENS. A year and a half later?

Mr. HARTSON. This question was in the solicitor's office involving a half dozen oil cases during that period of time—a year and a half; and I would like to account for that, too.

Senator COUZENS. Who was the solicitor at that time?

Mr. HARTSON. Mr. Mapes was solicitor during the entire period. The Britton Johnson case arrived January 22, 1921, about two months after the Equality Oil Co. case, and about a year later the Prairie Oil & Gas Co. case came in, involving the same question.

Doctor ADAMS. When was that—January, 1922?

Mr. HARTSON. December, 1921, about a year later—a little less than a year.

The practice in the office is when a request for an opinion comes in to assign the case to a lawyer for the purpose of going through the files and running down the law and doing the original work on the case, and that lawyer writes an opinion setting forth his views. This Britton, Johnson, Oil Co. case, and the Equality Oil Co. case, as soon as they came in were assigned to a lawyer in the office and were written up.

There was an opinion written in the Britton-Johnson case which reached a conclusion sustaining the regulations—in other words, disallowing lessee depletion, to put it roughly.

Senator COUZENS. What date was that?

Mr. HARTSON. The date of that I do not know that I have, and I do not know that it is really material, although I can find out for you very easily.

Senator COUZENS. I think that is quite material because the lessee depletion was allowed at that time and yet that was considerably after the time in which the depletion allowance was made to the Gulf Oil Co., was it not?

Mr. HARTSON. Yes; and I want to explain to the committee on that score that the Gulf Oil Co. case was never one of the cases that was referred to the solicitor's office for an interpretation.

Senator COUZENS. Do you recall why that was?

Mr. HARTSON. No; I have no idea.

Senator COUZENS. Is it not a rather peculiar situation that it was not referred, while all the others seem to have been referred for decision by the solicitor?

Mr. HARTSON. No; I do not know that it is, because a very small share of the cases are referred to the solicitor's office necessarily. The attempt is made to send a case or two to develop the question, and then possibly hold the balance of the cases in the unit until a ruling has been reached.

Senator COUZENS. But in this case they went ahead, and that is what I am trying to get at—the other cases seem to have been held awaiting a ruling by the solicitor's office, but the Gulf case was not held, and through either the auditor or some other division or section of the unit this case slipped through without a decision from the solicitor's office.

Mr. HARTSON. I can not account for the failure to send this case to the solicitor's office. It does appear that the Equality Oil Co.'s case presented the same question and that that was in the office several months before the Gulf case was settled.

The CHAIRMAN. How many oil cases presented that same question; do you know?

Mr. HARTSON. I can not say how many, but I do not think I would be stretching the facts at all to say that the larger number of oil cases that were not yet audited presented a similar question.

The CHAIRMAN. Were they all sent to the solicitor's office?

Mr. HARTSON. Oh, no; not by any manner of means.

The CHAIRMAN. That is what I wanted to bring out.

Mr. HARTSON. I have enumerated the cases that were sent to the solicitor's office, and in answer to the Senator's other question I would suggest that——

Doctor ADAMS. Did not cases involving refunds in cases of this kind automatically go to the solicitor's office?

Mr. HARTSON. They did, and I would like to have you ask me that question with regard to the Gulf case, if you want that in.

Doctor ADAMS. I do not want it now.

The CHAIRMAN. Will you give it after awhile?

Mr. HARTSON. Yes; oh, yes. After this lawyer reached the conclusion that the regulations should be sustained——

The CHAIRMAN. Who was that lawyer?

Mr. HARTSON. His name was Davis. I do not remember his initials, but his name was Davis. It was assigned to another lawyer—this case was assigned to the man who at that time was doing the oil and gas work in the law office. You may realize that the questions of law that arise in our office require special attention, and then, and now, we had a man who was specializing on oil and gas legal questions.

The CHAIRMAN. What was his name?

Mr. HARTSON. His name was Cosgrove. The cases, all of these that I referred to, were assigned to Mr. Cosgrove and remained there for some months; and due to his inability to get to the cases and get action on them because of other cases, many cases being on his desk, and other work he had to do, the files show he did not work on it; there is nothing in the files expressing any opinion from Mr. Cosgrove.

They were then assigned to Mr. Morris, and Mr. Morris wrote an opinion which sustained——

Doctor ADAMS. When were they assigned to him?

Mr. HARTSON. They were assigned to Mr. Morris about December of 1921. This was going on a year after the first case had arrived. Mr. Morris reached the same conclusion that Mr. Davis reached, and he wrote an opinion reaching the same result.

It was then assigned to a third lawyer, Mr. Price, and Mr. Price reached the conclusion that a reasonable interpretation of the question, that the 1917 act did not deny the right to the lessee to deplete and, therefore, that the regulations covering those acts were wrong. Mr. Price's conclusion was put in formal shape and received Mr. Mape's approval and became known as Law Opinion 1103, which was the basis for the Treasury Decision 3386, which did, in fact, change the regulations governing this item.

The CHAIRMAN. Senator Couzens, I am very much interested in what is going on in the Senate, and I want to give you this letter from Mr. Mellon to me in answer to one written by the committee. I wish this to be inserted in the record immediately after Mr. Hartson concludes his testimony. If you will excuse me I will go up on the floor; if you want me you can get me up there.

Mr. HARTSON. There was an attempt made, and it was finally successful, to get the question to court because it was one that the court ought to pass on, and so far as solid minerals are concerned in the Mohawk case, that is the case that I have already referred to, the court had denied depletion to a mining lessee, that is a solid mineral lessee, under the 1916 act, which is the same provision that we are concerned with here, holding that the allowance was available only to the fee owner; and on rehearing the court said:

> We think the substantial principles established by the decisions are that both the royalty received by the fee owner and the sums received by the operating lessee above the cost of operation are income; that the statutory deduction for depletion can not be twice credited, once to the fee owner and once to the lessee; and that the exemption belongs, by right, to the fee owner.

Of course it appears from that language that the court may have been acting under a wrong idea of the facts because I think it has been developed here, and if it has not been to the satisfaction of the Senator it should be, that there is not a double allowance for depletion. An allowance is made on the property and then there is an attempt to apportion that between the lessor and the lessee.

Senator COUZENS. Are you going to show us some figures as to the total amount of depletion allowed to the lessor and the lessee?

Mr. HARTSON. I think Mr. Greenidge has been getting those figures for you, Senator. The Senator asked for that some time ago.

That Mohawk case came out of the sixth circuit court of appeals. The eighth circuit court of appeals, in the case of Lynch *v.* Alworth Stephens Co. said with reference to this provision of the 1916 act, which is the one we are speaking of:

When one first reads this provision no doubt or uncertainty as to the parties to whom it authorized these allowances for depletion occurs to the ordinary mind. The suggestion does not arise that this is a grant to the owners of the fee titles to mines alone, or that the lessees and all others having property interests in them are exempt from the grant—

I say exempt; I mean excepted—

are excepted from the grant; it requires considerable search and study of an acute and ingenuous intellect to find and persistently assert that position. The plain, clear, and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to everyone whose property right and interest therein has been depleted by the extraction and dissipation of the product thereof which has been mined and sold during the year for which the return and computation are made. It is common knowledge that in the case of mines the property rights and interests therein and the income derived therefrom by lessees and others than those who own the titles to mines are much more valuable than the rights and interests of such owners, and it is difficult to believe that if Congress had intended by this grant of a reasonable allowance for depletion to restrict it to the owners of the titles to the mines and to except from its benefits lessees and those owning other property rights and interests therein it would have clearly expressed that intention by a restriction or by exceptions inserted in the act. The legal presumption is strong, it seems conclusive, that Congress never meant, and that it never intended to make, any such limitation or exception.

Now, that is an opinion from the eighth circuit court of appeals which came out recently, and that court, of course, had before it the two interpretations that the department had placed on the same provision.

Doctor ADAMS. Will that question be carried to the Supreme Court?

Mr. HARTSON. The certiorari has already been granted and the case is under way.

Senator COUZENS. I am still unable to understand why these depletion credits were allowed to lessees in February, 1921, when there was no opinion given out by the solicitor's office until December of 1921.

Mr. HARTSON. I do not know that I am able to answer that question, because I, myself, do not know; the records and files in the case shows that the question which was one in dispute and which was being raised generally by oil companies at that time was presented to those who had the audit of the returns to do, and the section chiefs, and the section heads were in conferences and listened to arguments and presentations of this disputed question at that time, and, as has already been pointed out, the allowance was finally made on the basis of the A–2 letter recognizing that it was still a disputed point, that if the department ultimately determined to adhere to its at that time present regulations, that the company would be required to make an adjustment with the Government on that basis.

Senator COUZENS. Was the Gulf Oil Corporation the first one that had a decision made like that in their A–2 letter?

Mr. HARTSON. It was not, and Mr. Greenidge, I think, testified the other day that there were some 20 companies where the question was similarly raised, and where there was a similar allowance made.

Senator COUZENS. I remember that, but I wondered whether the Gulf Oil Co. was the first one.

Mr. HARTSON. No; it was not the first one.

Senator COUZENS. Can you tell us which one?

Mr. HARTSON. I recall Mr. Greenidge's testimony that in 1917 Mr. Osborne, the then commissioner, instructed his revenue agents to audit in the field the books of the oil companies on the Gulf on a basis which permitted a similar allowance that was later made to the Gulf Co.

Senator COUZENS. Have you got the A-2 letter to the Gulf Co. here?

Mr. HARTSON. Yes, sir; I think we have; we have been bringing them back here daily, whether it was brought back to-day or not I do not know.

Mr. GREENIDGE. The office is working on them, Senator Couzens, and we have not got them here to-day.

Senator COUZENS. You say the A-2 letter pointed out that this depletion credit was not final?

Mr. HARTSON. Yes, I think so; and I think I pointed that out to the Senator; I remember reading it into the record. I can only paraphrase the language; I think the A-2 letter said that the allowance made for lessee's depletion for these years is made subject to a final determination of this question by the department.

Senator COUZENS. You do not know, then, who decided the first case in which lessee depletion was allowed?

Mr. HARTSON. Commissioner Osborne was the first one who expressed it in writing.

Senator COUZENS. Was he the first one that approved of the allowance?

Mr. HARTSON. You will remember that my statement with regard to what Commissioner Osborne had done was this: That he was instructing the field agents as to the basis they should use in making the audit in the field. Now, there was no allowance made at that time, there was a mere instruction as to how the field agent should proceed after the revenue agent's report came in to Washington. Then upon the audit the final allowance would or would not be made as the case might be. That showed the attitude of the department at that time, that they were not entirely satisfied that their regulations were correct or that they would be adhered to.

Senator COUZENS. Can you tell me the names of the men who settled this Gulf Oil Co.'s case who agreed to the A-2 letter?

Mr. HARTSON. Yes; I think we have all that information. Mr. Powell is one. His name has already been mentioned. Mr. Byrd is another, and Mr. Rush is another; and if there are any more their names do not occur to me. Mr. Lindsell was, I think, the section chief of the audit—I am inclined to think he was.

Doctor ADAMS. I want to make a statement about the situation, if it is agreeable to the committee, because in some aspects of it I think I can clear it up as much as anybody else.

Senator COUZENS. Proceed, Doctor Adams.

Doctor ADAMS. With respect to this question in a general way, possibly I might answer some questions. I formulated for the Treasury Department the administrative draft of the revenue act of 1918. I did the same thing for the revenue act of 1921.

This question was very conscious at all those times. I personally have felt that the rule announced in Weiss *v.* Mohawk Mining Co., that a lessee was not entitled to depletion, was wholly inequitable, uneconomic, and undesirable; that it should be changed.

The Treasury Department felt so also and I was directed and authorized and instructed to do everything I could to get lessee depletion recognized in the revenue act of 1918; and, personally speaking, I will be exceedingly glad if the courts can find their way clear to recognize lessee depletion under earlier acts. I think that is the sound and the wise and the equitable solution of the question.

Having stated that, I want to say that unequivocably the opinion of the heads of the department was at the time the revenue act of 1918 was adopted that lessee depletion was not authorized by law.

When the decision of the circuit court of appeals in Weiss *v.* Mohawk Mining Co. was handled down an attempt was made to take it up to the Supreme Court of the United States on certiorari, but the Supreme Court refused to hear the case. The doubts involved were still discusssed by the Commissioner of Internal Revenue and the men in authority in the Treasury Department, and they decided probably it meant, although they recognized doubts, as I say, that probably it meant that a lessee was not entitled to depletion.

I represented many times to the committees of Congress that under the opinion of the circuit court of appeals in question in the opinion of the law officials of the Treasury Department the lessee was not entitled to depletion under acts prior to that of 1918, and that this should be changed; and while I do not recall many discussions under the revenue act of 1921, representing the Treasury Department here at that time, I should have stated unhesitatingly that lessee depletion was not recognized when the law of 1921 was being discussed and adopted in the committees of Congress because of the printed regulations of the department.

I have not the slightest notion in the world that Secretary Mellon, or anybody connected with him, got anything that they ought not to have; I doubt if Secretary Mellon knows anything about this; I want no implication to be conveyed by my remarks; but I personally am shocked beyond all expression to know that cases were passed upon and went out from the Treasury Department contrary to the printed regulations of the department and feel like I ought to express that opinion on it.

Mr. HARTSON: Of course those cases were made prior to Secretary Mellon coming into the department.

Doctor ADAMS. Entirely so, but I mean it is one of the highly unfortunate features of the situation; and I have not any doubt that in answer to questions from Congressmen, Members of the House and Senate, about how the law was being administered that I told them emphatically that lessees were being denied depletion; and I have not any doubt at all that Congress enacted both the revenue acts of 1918 and 1921 firm in the belief that leaseholders had not been entitled to depletion prior to the act of 1918. I recall many times stating that that was probably the law in connection with the revenue

act of 1918; and I have no doubt that I stated it a number of times in connection with the discussions under the revenue act of 1921.

Senator COUZENS. When did you go in the department, Mr. Hartson?

Mr. HARTSON. I went in the department in June of 1922.

Senator COUZENS. Do you know anything about the case of Llewylen, Collector of Internal Revenue, *v.* W. L. Mellon and the United States.

Mr. HARTSON. I do.

Senator COUZENS. I have a letter here which says:

In connection with the investigation of the Internal Revenue Department, I should like to present these facts to you in the case of Llewelyn, Collector of Internal Revenue, *v.* W. M. Mellon:

The United States brought suit to recover $70,000 ($20,000) alleged income tax.

It was understood and agreed that a similar case that the United States Government had against A. W. Mellon for almost ten times that amount would await the result of this case and be settled on the basis of the decision in that case.

The question is whether or not dividends on 12,655 shares of Gulf Oil Corporation were earnings in which income should be paid.

In addition to these shares, Messrs. A. W. Mellon and R. B. Mellon owned 78,000 shares.

The tax to be paid in connection with the dividends on the stock belonging to A. W. Mellon and R. B. Mellon would be in the neighborhood of $500,000.

This case was tried before District Judge Orr in Pennsylvania, and was decided against the Government (277 Fed. 910). It was appealed and decided by the circuit court of appeals June 29, 1922 (281 Fed. 645). Andrew J. Aldridge handled the case for the Government. This case was decided against the Government. Andrew J. Aldridge was in the Department of Internal Revenue and strongly represented to A. W. Mellon and to Attorney General Daugherty that the case be appealed to the United States Supreme Court, which may be substantiated by the records in the office of the Department of Internal Revenue. His supervisor was strongly of the opinion that the United States Supreme Court would reverse the decision of the circuit court of appeals.

A. W. Mellon wrote a letter to Daugherty suggesting that the case be appealed. This letter had the approval of Aldridge and Mapes, but for some reason the time within which appeal could be taken was allowed to lapse without any action being taken, thus protecting the Mellon family from the possible loss of over $500,000.

Andrew J. Aldridge left the Department of Internal Revenue in June, 1922 and he wrote several letters to the department urging that appeal be taken.

After the time for appeal had lapsed Aldridge and other members of the Internal Revenue Bureau wrote to Mellon that in view of his interest in the matter he should waive the fact that the time had expired and allow the Government to appeal the case. This he refused to do.

I should prefer not to be quoted in this matter in any way. I think all the necessary facts can be obtained from the files of the Department of Internal Revenue.

Have you that case?

Mr. HARTSON. I have a complete statement regarding that, yes; and the misstatements that have been made in the letter that the Senator has read should be corrected immediately.

The case against A. W. Mellon is still in the courts and is still subject to litigation and final determination in the courts.

Senator COUZENS. What courts?

Mr. HARTSON. In the district court. It is pending in the district court now; it has been argued and we are expecting a decision very soon. If it is against us we are going to appeal to the circuit court of appeals, and if it is there decided against us we are going to the Supreme Court of the United States, for we believe the Government is right about it.

It is true that the test case with regard to one of the other Mellons, after it had been decided in favor of the Mellons by the district court was reaffirmed in favor of the Mellons by the circuit court of appeals; due to some lapse of time in the Department of Justice no appeal was taken to the Supreme Court of the United States, although Mr. Mellon, personally, as the writer of the letter suggests was ready to have it taken up. I think it was purely a mistake—it got pigeonholed somewhere over there, and for no other reason was the time within which the appeal to the Supreme Court of the United States could be taken allowed to lapse.

Senator COUZENS. Why did Mr. Mellon refuse to waive the lapse of time; do you know?

Mr. HARTSON. That is purely his right; it is his legal right. The Government did not make its move promptly enough; it is the Government's fault, not Mr. Mellon's; and so far as Mr. Mellon is concerned in this case, his case is still the subject of litigation. The other test case covered another member of his family, not the present Secretary of the Treasury.

Senator COUZENS. With the same principle involved.

Mr. HARTSON. The same principle was involved; and the whole thing is still the subject of litigation. The Government, by reason of its failure to take the appeal to the Supreme Court of the United States, assuming that the decision of the Supreme Court of the United States would reverse the two lower courts, will only lose the amount involved in that particular case. The case against the present Secretary of the Treasury and other members of his family is still in litigation and the Government's interests are being protected, and will be protected; but so far as the single individual is concerned the failure to take the appeal, assuming that the Government would have won the appeal, so far as that case is concerned, that is the only possible chance where the Government's interests will be harmed or prejudiced. Now, whether this relative of Mr. Mellon's would come out and say, "I am going to waive my legal rights and give the Government this money," is a question which is disputed. I can not answer it.

Senator COUZENS. I think you have stated that incorrectly. There was nothing said about giving any money to the Government, The question was one of waiving his right to insist on the time limit.

Mr. HARTSON. I do correct my statement to the extent the Senator suggests. Would the Senator like me to read this statement which has been prepared and which covers the situation generally?

Senator COUZENS. Have you prepared a brief statement?

Mr. HARTSON. I have stated it substantially in the contents of this memorandum.

Senator COUZENS. In response to a request made by the committee to Mr. Hartson, or Mr. Nash, asking for the names of the companies that Mr. Mellon was a stockholder in, he writes a letter addressed to the chairman of the committee, dated April 1, 1924:

In my letter to you of March 25, I informed your committee that three companies in which I was a stockholder had waived their right to privacy and were willing to have your committee investigate their tax returns. I stated that if question is later raised with respect to any other companies in which I may be interested I would be very glad to do what I could to obtain similar publicity to their returns. I understand from Mr. Hartson that some additional information from me is required by your committee in connection with other companies

in which I might be a stockholder. If you will be good enough to advise me the names of the companies and the questions which have been raised with respect to their returns I will be in a position to advise you what, if anything, I can do to facilitate your committee's investigation of these returns.

The request that the committee made contained no intimation that any question was raised about other companies. What the committee asked was if Mr. Mellon would give us a list of the companies in which he was a stockholder.

Do you desire, Mr. Hartson, that I write to him, or will you represent to him that what we ask is not the list of companies of which question has been raised, but a list of the corporations in which he is a stockholder?

Mr. HARTSON. I think that if the Senator wishes a reply on that point and considers that the present letter is not a definite reply to that it should go in writing so that the Secretary can answer it.

Senator COUZENS. The Secretary does not refuse the information that we asked in the committee, but avoids it; I do not say that he does it with any intention of not giving it because at no time during the discussion was any question raised about any other company that he was not a stockholder in, but the simple question was asked that he furnished a list of the corporations in which he is a stockholder; and in this letter he does not attempt to do it.

Mr. HARTSON. Yes, I think such a request should be made in writing to the Secretary.

Senator COUZENS. Will you also ask Mr. Mellon if he will give us a list of the holdings in each of these three companies which we have under investigation, namely, the Gulf Oil Corporation, the Standard Steel Car Co., and the Aluminum Co. of America, or whether he prefers to be subpœnaed to answer those questions.

Mr. HARTSON. I am assuming the Senator is going to include them in his letter.

Senator COUZENS. I will if you think I ought to. That is a separate question from this, an entirely different question; and we have not adopted the method of writing the Secretary each question we have asked; we have relied upon his subordinates to convey the information to him; but if a departure from that procedure is desired the committee will proceed in another way.

Mr. HARTSON. Senator, as you have already stated you expected to write to the Secretary asking for a list of his companies, in view of the fact that you are not satisfied with the reply which is now in the Senator's hands——

Senator COUZENS. That is true; but the extent of his holdings was not in the first question. I asked you to convey that information to him; but I will get both of those in writing.

Now, I would like to ask Mr. Ernst this question: Did you handle the case of the Standard Steel Car Co.?

Mr. ERNST. Yes, I did.

Senator COUZENS. We did not finish with that case yesterday.

Mr. HARTSON. No, Senator, we did not, and I would like to refer to one or two points that were raised yesterday when the Senator asked me for some information which I am now prepared to submit.

There was a reference yesterday afternoon to the Comptroller General and his interest in the Standard Steel Car Co. case. I find

that the Comptroller General, under date of November 2, 1923, wrote the commissioner as follows:

NOVEMBER 2, 1923.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

SIR: There is before this office the claim of the Standard Steel Car Co., Pittsburgh, Pa., for refund of $46,750.98 in connection with a payment made by it of internal revenue taxes for the year 1919.

It appears that in the final settlement of a contract made by the War Department to the claimant in 1919 an error was made resulting in an overpayment to the claimant of $81,820.17. This amount was refunded by it in August, 1923, and it is now alleged that the amount of income and excess profits taxes paid by it upon its earnings for 1919 was based upon its earnings including the overpayment made by the War Department and that had the overpayment not been made, the amount of tax paid would have been reduced by the sum of $46,750.98.

It is requested that an examination of the claimant's tax returns be made and this office advised as to whether its contention as to taxes paid and the allowable deduction, had the amount of the overpayment not been included in its returns, is correct.

Information is also requested as to whether contract 1312 between the claimant and the bureau has been executed to cover its taxes for 1919.

Your prompt attention will be appreciated.

For the Comptroller General.

R. L. GOLZE.

Doctor ADAMS. What was the date of that?

Mr. HARTSON. That was dated November 2, 1923, last November. That is the letter which came through to Mr. Leary.

Mr. Leary then wrote the folllwing letter, which is apparently undated, although there is a pencil date on it December 15, 1923:

COMPTROLLER GENERAL.

(Attention Solicitor Division of Law, General Accounting Office.)

Receipt is acknowledged of your communication dated November 2, 1923, symbols D. M. 383, relative to claim for refund filed by the Standard Steel Car Co., of Pittsburgh, Pa., in the amount of $46,750.98, which is before your office.

The questions involved will be given consideration by the income tax unit whose records do not indicate that an agreement under section 1312 of the revenue act of 1921 has been entered into by the above-named corporation and this bureau. You will be advised of the final determination upon completion of the examination of the case.

——— ———, *Commissioner.*

Senator COUZENS. Do I understand No. 1312 agreement has been entered into with them?

Mr. HARTSON. That is my understanding—that none has been entered into.

Senator COUZENS. But there was with the Gulf Oil Co.

Mr. HARTSON. There was with the Gulf.

There was a memorandum on that from the Comptroller General to the Commissioner of Internal Revenue, as follows:

FEBRUARY 1, 1924.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

SIR: Referring to letter of this office dated November 2, 1923, and your reply thereto without date, copies of which are inclosed herewith, you are advised that the Standard Steel Car Co. formally withdrew the claim for refund of taxes referred to therein. The information requested by this office, therefore, would not be required.

Respectfully,

J. R. MCCARL, *Comptroller General.*

If that does not explain it, I have here a little more detailed information of how this arose.

It appears that in 1923 the War Department reviewed the settlement of the shell contract with the Standard Steel Car Co., and as a result of the review they showed it was found that the material which was unaccounted for and it was determined by the War Department that this shortage amounted to approximately $80,000—it is eighty-one thousand some odd.

The Standard Steel Car Co. was notified of this shortage and immediately forwarded a certified check to the War Department to cover this amount. This payment was made under protest because it was claimed by the company that had the discrepancy been discovered in 1919, the year which was involved, its income would have been reduced in that amount by reason of the disallowance of so much of its claim against the War Department.

With the protest there was submitted a counter claim by which the company asked that the $81,000 due the Ordnance Division be reduced by the amount of the loss in fact due to the payment made in 1923 instead of 1919, which, owing to the change in tax rates, cost the company approximately $30,000—there was no excess profits tax for this year of 1923 due to the high brackets, apparently this $81,000 item had a very material effect on their tax for the year 1919.

Conferences with representatives of the War Department disclosed that the Comptroller General was taking the matter up. The company later withdrew their claim because of the fact that reopening the tax liability for 1919 involved so much trouble, expense, and time; then, having settled it finally after several years, the company is not making any further claims. That explains the Comptroller General's letter and I think completes the record. One further point upon which I wish to touch is this: The Senator asked me yesterday about the allowance by the department in the Lincoln Motor Car Co. of amortization because of the cost in expenditures of real estate, land. I have tried to run that down, and I find that the Lincoln Motor Car Co. case went to the committee on appeals and review, where the additional tax that was proposed to be assessed against them was there considered, and in the committee's formal opinion this observation is made: No loss can be said to have been sustained on the land and neither the receiver nor his counsel urge amortization of this asset.

I think the Senator must have been misinformed about that case, in view of that. There was a very substantial amortization allowance in that case, a very substantial one, but in this opinion, which is a formal opinion filed in the case by this committee, this appellate court, they found that not only was there none allowed but there had been no serious claim made for it.

Senator COUZENS. No serious claim, but some claim.

Mr. HARTSON. Possibly some claim.

Senator COUZENS. I want to ask Mr. Hartson if any other of the Mellon companies were closed under 1312 besides the Gulf Oil.

Mr. HARTSON. I have no information on that, Senator. I think we can determine that in each separate case. The Standard Steel Car Co. has not been closed; the Gulf Oil Co. has; the Aluminum Co. has not been.

Senator COUZENS. Do you recall whether there were any undetermined questions in the Standard Steel Car Co. case when we finished yesterday?

Mr. HARTSON. I think that the conference report, Senator, which could not be located yesterday afternoon has now been found on the Berwind-White case that was referred to yesterday.

Senator COUZENS. Have you got it there? If so, will you read it to us now?

Mr. CLACK (reading):

Taxpayer's conference: Berwind-White Coal Mining Co., Philadelphia, Pa., represented by R. S. Wilson, attorney in fact; C. W. Parkhurst, consulting electric engineer; H. C. Middleton, treasurer; and D. Badger, accountant, of Ernst & Ernst.

Matter presented:

The case is consolidated as to the income, hence only amortization was considered in our conference. Taxpayer admits generally that the facts with reference to his history and property are correctly stated in the engineer's report but contends that insufficient allowances have been made owing to inaccuracy of the ratios used in the following cases.

Senator Couzens, if you will pardon me, there follows a long itemization of costs which total $217,491 which the taxpayer contends shows a lower replacement cost of $9,195.90 than shown in the engineer's report.

Senator COUZENS. That is the original report you are reading from?

Mr. CLACK. Of the conference?

Senator COUZENS. Yes.

Mr. CLACK. No, sir; it is not the original; the original is here. This is a carbon copy. I have the original in the files.

Senator COUZENS. Why was the carbon copy made prior to the committee hearing?

Mr. CLACK. No, sir; this is a carbon of the original report.

Senator COUZENS. It is a carbon of the original report?

Mr. CLACK. Yes, sir.

Senator COUZENS. That is all right.

Mr. HARTSON. The original is in the file. The only difficulty about bringing the original is that it is bound in there and this is more easily handled.

After further discussion the office was willing to concede taxpayer's contention with reference to items 3, 4, 7, 8, 9, and 10 as shown above, because the ratios as to these items are considered inapplicable.

Taxpayer also contends that the plant as a whole is only 70 per cent in use as against 80 per cent computed in engineer's report. On this point it was agreed that additional data would be submitted, and if the information is as claimed by the taxpayer's representative the conference will recommend that value and use be reduced to 70 per cent.

Taxpayer also claimed amortization amounting to $120,579.14 on unit No. 3, costing $360,710.20 of its plant, which was constructed after the close of the war. This claim is based on the theory that the additional unit was an economic necessity. It developed, however, in conference, that the additional unit was to take the place of a similar plant situated somewhat remotely from the new units which were constructed during the war, and the conferees are, therefore, of the opinion that no amortization is allowable on this third unit.

An error amounting to approximately $9,000 was pointed out on sheet 2 of Exhibit A to report, the item being next to the last one on the page. The error is conceded and correction will be made accordingly.

It is understood that the additional data will be submitted at an early date; and in the meantime it is requested that no further action be taken.

Interviewed by J. C. Herring; J. W. Swaren, engineer; C. F. Rhodes, conferee. Initialed E. T. L.—Mr. E. T. Lewis was acting head of the section in the absence of Mr. De La Mater, I think. It is dated October 30 and 31, 1922.

There follows under date of November 8, 1922, a letter of the industrial department of the General Electric Co. to the Berwind-White Coal Mining Co.:

> In accordance with our conversation of recent date, I am attaching herewith copies of specifications covering one 3,500-kilowat, 3-phase, 25-cycle, 6,600-volt turbine-driven alternator for operation at 150 pounds gauge, 2-inch back pressure. The approximate price of this unit is $90,000. You will find that the turbine operates at a speed of 3,600 r. p. m., which is geared to the alternator, which runs at 500 r. p. m.
>
> If we can be of any further service to you kindly advise.

This letter is in support of their somewhat detailed and technical final report.

Senator COUZENS. I think that is all. Have you got the addresses of those witnesses that we were going to subpœna, Mr. Nash?

I think we are practically satisfied—at least I am satisfied on the question of the Standard Steel Car Co. for the present.

The other case that you have here is the Aluminum Co. of America. Have you the records of that case here?

Mr. HARTSON. Yes.

STATEMENT OF MR. H. A. WHITNEY, APPRAISAL ENGINEER, BUREAU OF INTERNAL REVENUE

Senator COUZENS. How long have you been in the department, Mr. Whitney?

Mr. WHITNEY. Two years and a half.

Senator COUZENS. Always in the same department?

Mr. WHITNEY. Yes, sir.

Senator COUZENS. What did you do in connection with the case of the Aluminum Co. of America?

Mr. WHITNEY. Made the examination, wrote the report in conjunction with Mr. De La Mater.

Senator COUZENS. At what time?

Mr. WHITNEY. It was from November 13 to December 23 that the physical examinations of the properties were made, after which we wrote the report.

Senator COUZENS. What year?

Mr. WHITNEY. From November 13 to December 23, 1921, we made the examination, and then wrote the report, which was finished February 22.

Senator COUZENS. For what year did you make the examination?

Mr. WHITNEY. We made the examination for the years 1918 and 1919.

Senator COUZENS. And that is the record you have here?

Mr. WHITNEY. Yes, sir.

Senator COUZENS. You have not examined any of the returns since the year 1919?

Mr. WHITNEY. No, sir.

Senator COUZENS. Those are the only two years that you dealt with?

Mr. WHITNEY. Those are the only two years that I dealt with.

Mr. HARTSON. Senator, let me interrupt you to say that Mr. Whitney is the engineer who made the valuation with regard to amortization. Of course, their amortization claim only went to those two years and the actual date of those returns and subsequent reports were made by somebody else.

Senator COUZENS. I just wanted to bring out that he is only dealing with the question of amortization and no other deductions or anything else. Have you got your report there?

Mr. WHITNEY. Yes, sir.

Senator COUZENS. Read it to us.

Mr. WHITNEY. May I read the chronology first?

Senator COUZENS. I beg pardon?

Mr. WHITNEY. Do you care for me to read in the chronological order of the events?

Senator COUZENS. If you please.

Mr. WHITNEY. This deals with tax return A–19 for 1918 and schedule A–26 for 1919. The following amounts were taken as amortization, based on the flat rate of 25 per cent of the cost incurred during the war period. These amounts are the amortization claimed in 1918: $6,055,527.26; and the amount claimed as amortization in 1919: $797,170.10, making a total amortization claim of $6,892,697.36.

On November 8, 1921, taxpayer submitted a revised claim based on a total cost of $37,026, 306.11, amortization claimed on this amount being $18,124,339.28, or 49 per cent of the cost.

November 13, 1921, field examination of taxpayer's properties was made by S. T. De La Mater, chief of the section of amortization, and H. A. Whitney, appraisal engineer.

The examination was completed December 23, 1921.

February 16, 1922, the engineer's report was submitted and reviewed, recommending amortization be allowed in the sum of $15,151,840.92 out of a total claimed of $18,124,339.28.

April 8, 1922, taxpayer filed a protest to certain findings of the engineer's report.

April 12 and 13 taxpayer's protest considered in conference. Thirty-seven items were protested to by taxpayer. Adjustment resulting from the conference is found in the engineer's report of May 26, 1922.

May 26, 1922, supplemental report submitted by the engineer in which an additional allowance was made to the taxpayer of $293,676.93 based on the post-war expenditures, which have been disallowed on the first report but were considered as commitments in the current report and as such were allowed.

April 16, 1923, a conference held, matters presented, taxpayer claims that amortization allowance should be based on regulation 62 rather than regulation 45 and pointed out that the engineer's report was dated February 16, 1922, and that regulations 62 were approved February 15, 1922, and that accordingly the amortization report should be based on the later regulations.

Decision: Major De La Mater, chief of the amortization, was consulted and agreed that this change may be made. Taxpayer agreed to submit additional data in order that proper action may be taken.

On May 24, 1923, taxpayer submitted the data referred to in conference.

June 26, 1923, second supplemental engineer's report submitted and reviewed. In this report additional amortization was allowed in the sum of $144,096.54 based on the conference of April 16, 1923.

Summary of amortization allowance: The report dated June 26, 1923. Total cost on which amortization is allowed, $31,602,703.81. Total amortization allowed, $15,589,614.39. Amortization disallowed, $2,678,821.43.

Would you like to take this, Senator?

Senator COUZENS. In other words, about 50 per cent was allowed; is that roughly correct?

Mr. WHITNEY. Approximately that; that is, 50 per cent of the cost.

Senator COUZENS. Yes.

Mr. WHITNEY. We allowed—but of what they claimed as amortization we allowed much more than 50 per cent; we allowed——

Senator COUZENS. I understand that; I was just getting at the relation of the amortization allowed to the cost of the property on which it was allowed.

Mr. WHITNEY. Yes, sir.

Senator COUZENS. In reading this report you referred to the fact that the taxpayer thought this claim should be allowed under Regulation 62 rather than Regulation 45?

Mr. WHITNEY. Yes, sir.

Senator COUZENS. Because Regulation 62 was promulgated on February 15, 1922, and your report was dated February 16, 1922. What was the difference between those regulations?

Mr. WHITNEY. One regulation took the spread of amortization to the end of the amortization period, and the other regulation—62—had a different basis in which it was spread, according to a long drawn-out formula, but it gave a better advantage to properties tnat were acquired during the amortization period but were not used in war work. That is 185–B as Doctor Adams will recall.

Senator COUZENS. Well, because Regulation 62 was issued one day prior to your report, although your examination took place several months before the taxpayer was permitted to come under Regulation 62. Can you explain why that was?

Mr. WHITNEY. I can cite you the conference report, Senator; I have that here.

Senator COUZENS. Well, please cite it to us. Has this case been closed up, do you know, under section 1312?

Mr. WHITNEY. I think it has; Mr. Leary could inform you.

Mr. HARTSON. It has not, Senator.

Senator COUZENS. It has not?

Mr. HARTSON. It has not.

Senator COUZENS. Who signs these settlments under section 1312?

Mr. HARTSON. The commissioner and the Secretary.

Senator COUZENS. Then the Secretary signs an agreement to close the tax on his own companies, does he not?

Mr. HARTSON. He is necessarily required to do so under the law. With regard to the 1312 agreement in the above case the suggestion has been made that when the Gulf case was considered under 1312 sometime last summer, if my information is correct, the Secretary was absent in Europe and personally did not sign that particular agreement, but the law does require that the commissioner enter into the agreement with the approval of the Secretary.

Senator COUZENS. Can you bring a copy of that 1312 settlement here?

Mr. HARTSON. Yes, we had it here the other afternoon.

Senator COUZENS. As I remember it, it was not entered into until the fall rather than in the summer.

Mr. HARTSON. Well, I am only telling you my information, and I think that is the record, that it was signed by the Acting Secretary during the Secretary's absence. I do not know definitely about it but we can find out about it and give you the definite information.

Senator COUZENS. From your experience in the department, Mr. Hartson, do you know of any other company in which Mr. Mellon is interested other than those he has enumerated in his letter?

Mr. HARTSON. I do not know of any other companies, Senator Couzens, than those that he has mentioned here.

Senator COUZENS. Do you, Mr. Nash, know of any other companies?

Mr. NASH. No, sir.

Senator COUZENS. Do you know if the Mesta Machine Co. is a subsidiary of one of the other companies?

Mr. NASH. I never heard the name before.

Senator COUZENS. Do you, Mr. Ernst, know of the Mesta Machine Co.?

Mr. ERNST. I have heard the name but I have never heard it associated with Mr. Mellon; I have no knowledge whether he is interested in it or not.

Mr. WHITNEY. This report covers several pages.

Senator COUZENS. What date is the conferee's report?

Mr. WHITNEY. April 16, 17, and 18, 1923.

Senator COUZENS. We were asking you with reference to the advantage gained by using regulations 62 rather than regulation 45. Can you tell us from that report the way it dealt with the matter?

Mr. WHITNEY. I was not in on that conference; I was in the West at the time this conference took place, Senator.

Senator COUZENS. But I mean can you read from the conference report where it deals with that?

Mr. WHITNEY. I think so. Taxpayer's brief, sworn to March 13, 1922, provides the basis for discussion and decision. Assessment letter mailed February 12, 1923. The capital expenditure charges to "expense." Taxpayer contends that in view of the comparatively small amount charged against expense (over $250,000 construction items and over $200,000 furniture and fixtures, as compared with $40,000 total capitalization), that these should be allowed.

That was one of the items that the auditor threw from expense into capital, and the reason that the taxpayer claimed amortization was that it was a capital expenditure and as such should be amortized in a similar manner to main facilities with which it was thrown.

That is one of the $144,096.74 items.

Now, the "Contention" disallowed in accordance with article 24, regulation 62, paragraphs 2 and 3. Contention allowed as to certain items erroneously disallowed as follows—do you want me to read this?

Senator COUZENS. Can you tell us briefly, if you know, just what the difference between this regulation 62 and regulation 45 is?

Mr. WHITNEY. Yes. Either the auditor or the solicitor could tell you that better than I.

Doctor ADAMS. Senator, I can probably answer that question. The original calculations provided that amortization should be spread in accordance with net income, as I recall; that is to say, the allowance for amortization should be taken in the years included in the amortization period in accordance with the net income in those periods. That was the general purpose, as I recall, in the regulations 45. Later it was provided that the regulations should be changed, as I recall, again perhaps imperfectly, in accordance with the gross expenditure on the property amortized and goes to the time the costs were made. That, as I recall, is the general difference.

Senator COUZENS. Apparently regulation 62 was more favorable to the taxpayer.

Mr. WHITNEY. You could shift it into earlier years; I think that is substantially right.

Doctor ADAMS. My statement is made subject to correction. I am speaking from memory without any recent refreshing on the subject.

Senator COUZENS. Does the conferee's report show the difference of the actual allowance as the result of taking regulation 62 instead of regulation 45?

Mr. WHITNEY. It does not, Senator, but the amended report No. 2 gives in the report, on that and all other items considered at the conference, the allowance and disallowance, and the sum total is, if I remember correctly, $144,096.74 additional allowance.

Senator COUZENS. On what kind of property was this amortization claim allowed?

Mr. WHITNEY. It was facilities for the getting of bauxite out of the ground—mining property, steam shovels, crushers, agitators, etc., and then at East St. Louis they had a big plant for reducing the bauxite to alumina, and a concentrating plant, and a nitrate plant; and then down at Alcoa, and Niagara Falls, Messina, N. Y., and Baden, N. C., there were installed electric furnaces, which consisted of facilities for smelting the alumina and converting it into aluminum.

Senator COUZENS. After all this was done, do I understand these facilities were not used?

Mr. WHITNEY. No, sir, Senator; they were used, but they were used in such a reduced state that they could have done without a great many of them. The claim was based on value in use, and a reduced value of certain facilities.

Senator COUZENS. In other words, you took the additional cost due to war conditions and reduced that to what the cost would have been post-war?

Mr. WHITNEY. In normal times.

Senator COUZENS. And then you also allowed for excess capital?

Mr. WHITNEY. There were two classes, one as normal value and use.

Senator COUZENS. Is not that the same as excess capital when you reduce it to normal percentage in use?

Mr. WHITNEY. Some of them were not used at all. There were many ramifications in that claim, covering some twenty-one different subsidiary companies and plants and I had to consider a great many different angles to it.

Doctor ADAMS. While the Senator is looking at that report, was this entire amortization claim granted assigned to the taxable year 1918?

Mr. WHITNEY. Oh, no; the amortization period terminated on September 30, I believe in 1919, and there is part assigned to 1918, and part to 1919.

Doctor ADAMS. The end of the amortization period being based upon the end of expenditures for the properties amortized; is that it?

Mr. WHITNEY. No; there were a great many disallowed, that is many of the 1919 expenditures were disallowed. We only allowed such expenditures as we thought were necessary to complete certain facilities without the taxpayer suffering an undue loss.

Doctor ADAMS. No land amortization in this case?

Mr. WHITNEY. No; that was one of the "bones of contention."

Senator COUZENS. Was there any depletion credit allowed in the using of the boxite?

Mr. WHITNEY. No, sir.

Senator COUZENS. In your summary, or report, it says, "Depreciation has been deducted in respect to property acquired between April 6 and December 31, 1917." Do I understand depreciation was allowed in addition to amortization?

Mr. WHITNEY. No, sir; amortization takes place in the year 1918, but on facilities which were required for war purposes between when we started the war, April 6 and December 31 are allowed amortization, but we depreciate them for the year 1917, and we deduct depreciation from the total cost of those facilities that were acquired in the year 1917.

Senator COUZENS. I see by this report that it says that on the cost of the property not completed in time for use in war production the amortization allowance was $9,089,746.67 on the 1917–18 costs of $15,599,573.16. Do I understand that this was a new work and uncompleted when you examined it?

Mr. WHITNEY. No; a portion was completed when the war activities ceased. Uncompleted property (and I presume it is uncompleted now) was in an uncompleted state, buildings—a big part of them—there are buildings at Baltimore that stand there rusted and overgrown with weeds and poison ivy.

Senator COUZENS. That was the question I asked: When you went to examine this property was it uncompleted?

Mr. WHITNEY. A great deal of it was uncompleted and some that was completed, and so far as we found they were not using it and had not been using it—some that they had completed was at East St. Louis, the nitrate plant. That was in a completed state and they used that partly during the war and then abandoned it and locked it up. They had an almost duplicate plant for the manufacture of alumina at East St. Louis that was abandoned. They did not claim abandonment, but they claimed a reduced value in use of 25 per cent; and then in Alcoa, Tenn., they had, I believe, 16 smelting furnaces that never had been used at all.

Senator COUZENS. Just a minute at that point; you say they claimed 25 per cent?

Mr. WHITNEY. Yes, sir.

Senator COUZENS. That was afterwards changed so they were allowed practically 58 per cent; is that not correct?

Mr. WHITNEY. No; they had two claims, one on balanced and one on unbalanced facilities. The balanced facilities were allowed 50 per cent value in use, and 44 per cent amortization; and the unbalanced facilities were, to a large extent, allowed 25 per cent value in use, as we call it, and 75 per cent amortization. Those facilities are taken up in the same claim, and the reasons for the allowance given therein.

Senator COUZENS. Do you want to ask any questions, Doctor Adams?

Doctor ADAMS. I think it might be well to let the witness elaborate his statement about land a little. You say they have claimed amortization on land but it was not allowed?

Mr. WHITNEY. I might refer you, Doctor Adams, to the 37 points in which they came back with contentions that the amortization should be allowed. I have taken them up item by item, given their claim and my reasons for disallowance, and my reasons for redisallowing their claim in full.

Doctor ADAMS. My sole point is that after careful consideration amortization of land was disallowed in this case.

Mr. WHITNEY. I think there was some land that was allowed to a certain amount in the East St. Louis case, but they claimed an allowance that we did not anywhere near consider.

Senator COUZENS. What did they claim for amortization on land?

Mr. WHITNEY. I will have to look through this file, Senator, to find it.

Senator COUZENS. Is that the conferee's report there?

Mr. WHITNEY. This is my report on the conference.

Senator COUZENS. That is not your report on your examination?

Mr. WHITNEY. Here is my report on the examination. That is the main report, and then this is the 37 items that they took exception to at a conference. I answered their questions. Here it is—Item No. 10, to which the taxpayer took exception—item No. 10, it is "Works No. 2, East St. Louis, Ill." The claim for amortization was $75,959.94 based on a total cost of $172,636.26.

Senator COUZENS. That is for amortization on land, is it?

Mr. WHITNEY. Yes.

Doctor ADAMS. Entirely?

Mr. WHITNEY. On accounts to which they took exception and to which they set forth their protest in writing.

Senator COUZENS. I say that is on land?

Mr. WHITNEY. Yes; partly land, partly for facilities; not all land, but it mentions land in part of it. The amount of amortization claimed on $172,636.26 costs is $75,959.94.

In commenting upon the above disallowance the taxpayer mentioned the fact that it recognized that $77,710.12 represents corrections by the auditor of the section to which it agrees. It is unable to understand the reason for the remaining $94,926.44 eliminated from expenditures made prior to December 31, 1918.

In commenting upon this item the taxpayer mentions that "this is not explained in the report of the amortization section and is doubtless an omission in the writing of the report. It requests that the engineer explain the disallowance."

The engineer's explanation of the above was that the taxpayer possibly had omitted reading page 18 of the engineer's report in

which it was specifically stated that this deduction was made from the cost upon certain lands shown in the taxpayer's schedule, volume 2, page 21, item 1. The amount of such deductions was $88,754.50. The reason for this deduction was that the engineers, from their talk with the taxpayer, Mr. Fox, manager of the East St. Louis plant, decided that the land had not depreciated in value since the war.

The difference between $94,426.44, and the item $88,754.50 was explained by the fact that $7,098.46 more had been deducted, according to the taxpayer, than was shown by the auditor's check. It is recommended by the engineer that no further allowance be granted the taxpayer on this item.

Page 18 of that report goes a little more in detail to my reasons for disallowing the taxpayer's land claim, Senator.

Senator COUZENS.. In this report I notice on page 11 there is a town site on which they claim amortization of $471,086.88, made up of vacant houses, stores, sidewalks, grading, etc. Did you examine all that to see whether that was put in there because of the war necessities?

Mr. WHITNEY. I did, Senator; I went over everything.

Senator COUZENS. And you concluded they were entitled to amortization on that?

Mr. WHITNEY. That they were justly entitled to amortization on that. I did not give them full allowance, because they came back in those "Thirty Seven Items" with a protest. Is that the Pine Grove Realty Co.?

Senator COUZENS. It is called town site, Alcoa plant.

Mr. WHITNEY. In this report it shows they claimed $330,991.47. We allowed amortization in the amount of $145,636.25.

Senator COUZENS. Now, you are speaking about the land, are you?

Mr. WHITNEY. I am speaking about the Alcoa town site that you were speaking about; that is item No. 2, town site at Alcoa, Tenn. The cost disallowed in this item amounted to $330,991.47. The amount of amortization disallowed on the above cost was $145,626.25. The reason for the disallowance was that all the costs were incurred in the year 1919.

Taxpayers' arguments in regard to the disallowance of costs subsequent to the date of December 31—do you want me to read that?

Senator COUZENS. Yes.

Mr. WHITNEY. The taxpayers arguments are as follows:

1. All expenditures incurred subsequent to the date of December, 1918, should be given the same consideration for the reason that the company had under way an enormous program which was being pushed to completion almost regardless of expense.

2. The signing of the armistice was no positive guarantee that the war was over and that the production of these facilities would not be required for war purposes.

3. Committments had been made that could not be canceled; much of the material delivered after the close of 1918 had been manufactured or fabricated during 1918; hence, cancellation could not have been effected.

4. Taxpayer claims that, exclusive of the steamships and barges, only 15 per cent of the total costs were expenditures subsequent to the date of December 31, 1918. It claims that it is a reasonable "hang over" as could be expected from such an extensive program.

5. It is the request of the taxpayer that in the event that expenditures specifically referred to in the taxpayers protest can not be considered amortizable to

end of the amortization period, a sufficient portion of the costs recorded in the year 1919, should be allowed to absorb the "lap over" items upon which work had so far progressed that cancellation was impossible.

Senator COUZENS. That is enough of that, I guess.

Mr. WHITNEY. This is my answer to it: The Government's attitude regarding the above arguments:

1. The Government has given due consideration to all expenditures made subsequent to the date of December 31, 1918. This was explained to the taxpayers in conference and a very liberal allowance was made upon several of the items.

2. While the signing of the armistice was no positive guaranty that the war was over, yet the Government indicated its attitude regarding its need of the taxpayer's product quite clearly when it canceled 22,320,985 pounds of aluminum in December, 1918. During the 10 months of the amortization period in 1919 the taxpayer only shipped 2,759,546 pounds of aluminum, 72 per cent of which was shipped in January.

Table 1 on page 3 of the engineer's report gives the canceled orders and the shipments. It would seem that the Government's action would indicate that there was no further need of constructing facilities for war purposes.

3. In regard to commitments that had been made in 1918 but could not be canceled, hence were delivered in 1919, the Government, as indicated above, in paragraph 1, in answer to taxpayer's arguments, has given due consideration to all 1919 claims and made due allowance, details which will be explained more fully in the following paragraph.

Senator COUZENS. I guess that is explanation enough. Do you know of anything, Mr. Nash, that we left undone yesterday?

Mr. NASH. The Senator asked for copies of letters from the Standard Steel Car Co. and the Gulf Co. in which they acquiesced in having their reports submitted to the committee. Now, the letter from the Aluminum Co. of America has been misplaced in the commissioner's office; I was not able to find it to-day, but I will try to have it to-morrow.

Senator COUZENS. The committee is going to hold a meeting to-morrow at 1 o'clock to lay out a further program. I do not think it will be necessary for you gentlemen to come down to-morrow.

Doctor ADAMS. May I ask one further question?

Senator COUZENS. Yes.

Doctor ADAMS. Was any material amount of amortization allowed on vessels and barges?

Mr. WHITNEY. Yes; quite a bit.

Doctor ADAMS. Were they employed in the United States or for ocean-going traffic?

Mr. WHITNEY. For ocean-going traffic.

Mr. ERNST. Senator, will there be any necessity of my coming back?

Senator COUZENS. I do not think it will be necessary, Mr. Ernst. I have some railroad hearings the balance of the week which I must attend. I do not think it will be necessary for you to come back. If we want you, we will notify you.

(Thereupon, at 5.20 o'clock p. m., the committee adjourned to 1 o'clock p. m. Thursday, April 3, 1924, to meet in executive session.)