REVENUE ACT OF 192[illegible]

HEARINGS

BEFORE

THE COMMITTEE ON FINANCE
UNITED STATES SENATE

SIXTY-NINTH CONGRESS

FIRST SESSION

ON

H. R. 1

AN ACT TO REDUCE AND EQUALIZE TAXATION TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

JANUARY 4, 5, 9, 12, 13, AND 14, 1926

WITH INDEX

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REVENUE ACT OF 1926

MONDAY, JANUARY 4, 1926

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

The committee met in Room 310, Senate Office Building, at 10 o'clock a. m., pursuant to call of the chairman, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Watson, Reed of Pennsylvania, Ernst, Stanfield, Wadsworth, McKinley, Shortridge, Simmons, Jones of New Mexico, Harrison, King, and George.

Present also: The Secretary of the Treasury (Mr. Mellon) and the Undersecretary (Mr. Winston).

The CHAIRMAN. The committee will come to order. I desire to say to the members of the committee that the Secretary of the Treasury, Mr. Mellon, is here. I requested that he appear this morning and make a statement on the bill as it is now before the committee and as it passed the House. I have not indicated to the Secretary any particular line, other than to say that whatever he thinks is of importance in the bill for this committee to hear his explanation of, we will give him ample time to make a statement.

Now, Mr. Secretary, we will be very glad to hear you. You may either stand or sit, just as you desire.

Secretary MELLON. From where I was sitting I could not see all of the members, and perhaps I better stand.

STATEMENT OF HON. ANDREW W. MELLON, SECRETARY OF THE TREASURY

Secretary MELLON. I do not have any prepared statement. The Treasury recommendations were given to the Ways and Means Committee, and the House bill, which is before you, does not vary to any important extent generally from any of the recommendations made, excepting in two particulars; and they are (1) as to the exemptions and (2) the estate tax.

As you gentlemen know, the Treasury's recommendation was for the entire elimination of the Federal estate and inheritance tax features. As to the surtax, the Treasury's recommendation was to limit the maximum rate of 20 per cent to the $150,000 income, while the Ways and Means Committee of the House fixed the limit on the $100,000 bracket.

The line of rise in rates from the beginning is uniform. The principle in fixing a line of rates is, of course, to fix the maximum and then

to make a uniform schedule up to that maximum. That has been done in the House bill that is before you, rated up to $100,000, and then above that——

Senator SIMMONS (interposing). Mr. Mellon, let me ask you for information right at that point. You say the principle in fixing a line of rates is to take a maximum and then make the other rates uniform. How can you well make them uniform in any graduated scale where you jump to $2,000, and then jump to $4,000, and finally jump to $10,000, and adding each time only 1 per cent; how can that be quite uniform?

Secretary MELLON. It is in general a uniform line. Of course it is not practicable to make an exact uniform variation in the steps, but the line followed is a uniform line from the lower surtax rates up to the 20 per cent maximum. That is, on the percentage of the total income tax.

Senator REED of Pennsylvania. Are you satisfied with the scaling of the surtaxes?

Secretary MELLON. Yes; I think it is a logical scaling up to the maximum.

Senator REED of Pennsylvania. I was contrasting them with the scaling of the 1917 law, where the surtax went up so high as 63 per cent, if I remember correctly, and there at $100,000 of income the surtax was only 17 per cent.

Secretary MELLON. I think if you take the 1918 basis that from that you can see just how this schedule applies. There is a question about some of the intermediate rates. These rates in this bill were all fixed by the Ways and Means Committee of the House of Representatives.

Senator REED of Pennsylvania. That is what I mean. The Treasury did not recommend this scale of surtaxes.

Secretary MELLON. Oh, no. We just gave in a general way the idea that the maximum rate should be fixed and then that the rates should be scaled up to that maximum. And the rates as adjusted by the Ways and Means Committee of the House of Representatives are in the bill that is before you, but those were not given by the Treasury Department at all.

Senator SIMMONS. What you suggested was a 20 per cent maximum, to be reached at an income of $150,000.

Secretary MELLON. Exactly.

The CHAIRMAN. You have not spoken of the effect that the increase of earned income from $10,000 to $20,000 that the 25 per cent reduction has on the early brackets.

Secretary MELLON. As to the early brackets—well, in fact all the way through there is the benefit of the earned income provision, which applies to a very large percentage, to 60 per cent to 80 per cent of the incomes through these intermediate brackets.

Senator HARRISON. Mr. Secretary, in view of what the House has done—and it has fixed the maximum of 20 per cent at an income of $100,000, I believe.

Secretary MELLON. Yes.

Senator HARRISON. Do you still insist on the wisdom of your suggestion of making the 20 per cent apply to incomes of $150,000?

Secretary MELLON. It is a question of amount of revenue to be secured. A large number of taxpayers come in, say, from $30,000

to $60,000 or $70,000, and in order not to make too great a deficiency in revenue it is necessary to have the rates follow up to some point, and the difference is not so very great between running up to the $100,000 limit and to the $150,000 limit.

Senator SIMMONS. The income derived would be very little larger by stopping at $100,000.

Secretary MELLON. Quite a little larger. And, you must remember, there was a large amount of revenue lost through some reductions in other matters, such as in automobile tax. They found it necessary to keep their rates intact or to follow up through the line.

The CHAIRMAN. Have you come to any definite decision as to the amount of reduction it would be safe to make?

Secretary MELLON. On the whole, do you mean?

The CHAIRMAN. Yes.

Secretary MELLON. I think in the matter of reduction that we should not go beyond $330,000,000.

Senator KING. Is that based on the Budget recommendation?

Secretary MELLON. Yes; on all our estimates, the Budget estimates and the Treasury estimates.

Senator SIMMONS. Mr. Mellon, you say we should not go beyond $380,000,000 by way of reduction——

Secretary MELLON. No; $330,000,000.

Senator SIMMONS. That is what the House put it at?

Secretary MELLON. Yes. The estimates of the Treasury Department gave a margin of $250,000,000. But the House of Representatives went beyond that, to the extent of $330,000,000.

Senator SIMMONS. That contemplates a sinking fund of how much?

Secretary MELLON. Of about $310,000,000.

The CHAIRMAN. Of 2½ per cent.

Senator SIMMONS. Did you say it contemplated a sinking fund of $310,000,000?

Secretary MELLON. Yes, sir.

Senator SIMMONS. Upon $10,000,000,000, is it not?

Secretary MELLON. Yes; upon $10,000,000,000—it is practically one-half of the total indebtedness.

Senator SIMMONS. One-half of the total bonded indebtedness?

Secretary MELLON. Yes.

Senator SIMMONS. You said something awhile ago about earned income. Every taxpayer gets some benefit from the differentiation in favor of earned income, does he not?

Secretary MELLON. No; but about 80 per cent of the taxpayers do get some benefit from it.

Senator MCLEAN. What was the 1924 surplus?

Senator KING. It was a little over $300,000,000, was it not?

Undersecretary WINSTON. No; it was $505,000,000. That was the 1924 surplus.

Senator SIMMONS. How much was that?

Undersecretary WINSTON. $505,000,000.

Senator KING. Oh, I was mistaken as to the year. I had in mind the year 1925.

Undersecretary WINSTON. The surplus that year was $250,000,000.

Senator KING. And the surplus for 1924 was applied in payment of some of our bonds, to redeeming some of our bonds, was it not, Mr. Undersecretary?

Undersecretary WINSTON. All surplus has gone automatically into debt reduction.

Senator McLEAN. You are speaking of what has been done?

Secretary MELLON. Yes. The sinking fund is based on one-half of the total of the oustanding debt. We have in addition repayments on our foreign debt settlements, but they will be small for some years to come.

Undersecretary WINSTON. I have here a statement which shows the public debt retirements and from what they have come. Since 1919 they——

Senator SIMMONS (interposing). Pardon me, before you read that. You say there have been some payments on foreign debt settlements, but that they are small. They will grow a little larger as the years go on?

Secretary MELLON. Yes.

Senator SIMMONS. You will apply that difference?

Secretary MELLON. Yes.

Senator SIMMONS. That is applied annually to our debt?

Secretary MELLON. Yes.

The CHAIRMAN. The law requires that.

Senator SIMMONS. I understand that. But I wanted to know about the situation. Annually, Mr. Secretary, you apply what you receive from foreign debt settlements to the public debt of the United States?

Secretary MELLON. Yes.

Senator SIMMONS. That will take care of the other $10,000,000,000 very well, will it not?

Undersecretary WINSTON. It will in 62 years, if the payments are made.

Senator SHORTRIDGE. Will you gentlemen have the goodness to speak a little bit louder in order that we at this end of the table may hear you.

The CHAIRMAN. Mr. Mellon, if you will speak a little louder, it will be appreciated by the members of the committee at the other end of the table.

Secretary MELLON. Very well.

Senator McLEAN. I should like to have put into the record at this point that the 1924 surplus was $505,366,000, and that the 1925 surplus was $250,505,000.

The CHAIRMAN. Now you may give that information, Mr. Secretary.

Secretary MELLON. On the settlements which have been negotiated—and which are substantially all to be negotiated with the exception of the French settlement—and we can not expect in the early years any large payments, the totals to be received, in round figures, are as follows:

Year	Amount	Year	Amount
1926, principal and interest	$174,000,000	1931	$194,000,000
1927	175,000,000	1932	194,000,000
1928	175,000,000	1933	208,000,000
1929	178,000,000	1934	221,000,000
1930	180,000,000	1935	221,000,000

In the first 10 years the increase is very gradual.

The CHAIRMAN. An after that it increases annually?

Secretary MELLON. Yes.

Senator KING. The retirement provisions are made for, approximately, $10,000,000,000. What does the law require by way of retirement for the residue of our obligations?

Undersecretary WINSTON. That is supposed to be taken care of by the requirement that we use the proceeds of repayment of foreign principal in retirement of our debt. That is all it takes care of.

Senator SIMMONS. Mr. Mellon, under what provision of the law are you now setting aside this $310,000,000, as a sinking fund?

Secretary MELLON. That is under section 6 (a) of the Victory Liberty loan act.

Senator REED of Pennsylvania. That provides that the sinking fund shall consist of 2½ per cent upon bonds not floated for the purpose of foreign governments, plus interest on the retired sinking fund.

Secretary MELLON. Yes.

Undersecretary WINSTON. If the committee desires I have a statement of the war debt reduction from various sources, bringing it down to December 31, 1925.

Senator SIMMONS. I think all information of that sort we can get should be put in the record. I would like very much if you would run that statement on foreign payments, too, on up to the 62 years, that you have given.

Undersecretary WINSTON. It can be done, but that is pretty far in the future I would suggest.

Secretary MELLON. And from all the best estimates that can be made at the present time it is not safe to go beyond——

Senator SIMMONS (interposing). Why did you settle upon a sinking fund for one-half of the indebtedness of the United States Government?

Undersecretary WINSTON. That was the provision made by Congress. It was a statutory provision directing us to do it.

Senator SIMMONS. Does Congress require that in the statute?

Undersecretary WINSTON. Yes; that is the Victory Liberty loan act.

The CHAIRMAN. It was based upon half of the amount of our debt, which was about $10,000,000,000, at 2½ per cent. It was $254,000,000 to begin with.

Undersecretary WINSTON. I would suggest that that was done before Mr. Mellon was made Secretary of the Treasury.

Secretary MELLON. And in that act Congress contemplated that the returns of payment from foreign governments would take care of the other half.

Senator KING. Assume for the purpose of the question that we shall fail in that anticipation, then we have no provision for caring for the residue of the debt of over $10,000,000,000?

Secretary MELLON. No; other than to the extent that the statutory provision provides.

Undersecretary WINSTON. The sinking fund itself is not limited by the statute to the $10,000,000,000, and after the $10,000,000,000 has been retired by the sinking fund, the so-called domestic end of the debt, then the sinking fund would still operate to retire the other. But, of course, it would mean that the retirement would be extended many years beyond what Congress originally contemplated when they passed the Victory Liberty loan act.

Senator SIMMONS. Your 2½ per cent for one-half of the public debt is fixing that debt at $20,000,000,000. It would retire $10,000,000,000 within 25 years.

Secretary MELLON. I think that is right. That is the basis on which it was calculated.

The CHAIRMAN. As to the 2½ per cent retirement provision, it was thought at the time of the passage of the Victory Liberty loan act that it would take 31 years and a fraction at 2½ per cent to retire the amount.

Senator SIMMONS. I understand, then, that you, Mr. Chairman, and the Treasury Department disagree?

The CHAIRMAN. Oh, no. You are now talking about $10,000,000,000, and I am talking about $13,000,000,000 that was originally in mind.

Senator SIMMONS. Oh.

Secretary MELLON. And we have had reductions that have come from other sources in addition.

Senator SIMMONS. I was only speaking of $10,000,000,000 of our indebtedness. You have arbitrarily fixed that amount for which you will provide a sinking fund under the Victory Liberty loan act, and the amount of sinking fund prescribed and followed by you would retire that $10,000,000,000 within 25 years.

Undersecretary WINSTON. That is right.

The CHAIRMAN. If you desire, I will read this provision of the Victory Liberty loan act.

Senator SIMMONS. I do not object at all.

Senator KING. That is section 6 (a) of the Victory Liberty loan act, as I understand.

The CHAIRMAN. Yes. It reads as follows:

CUMULATIVE SINKING FUND

SEC. 6. (a) That there is hereby created in the Treasury a cumulative sinking fund for the retirement of bonds and notes issued under the first Liberty bond act, the second Liberty bond act, the third Liberty bond act, the fourth Liberty bond act, or under this act, and outstanding on July 1, 1920. The sinking fund and all additions thereto are hereby appropriated for the payment of such bonds and notes at maturity, or for the redemption of purchase thereof before maturity by the Secretary of the Treasury at such prices and upon such terms and conditions as he shall prescribe, and shall be available until all such bonds and notes are retired. The average cost of the bonds and notes purchased shall not exceed par and accrued interest. Bonds and notes purchased, redeemed, or paid out of the sinking fund shall be canceled and retired and shall not be reissued. For the fiscal year beginning July 1, 1920, and for each fiscal year thereafter, until all such bonds and notes are retired there is hereby appropriated, out of any money in the Treasury not otherwise appropriated, for the purpose of such sinking fund, an amount equal to the sum of (1) 2½ per cent of the aggregate amount of such bonds and notes outstanding on July 1, 1920, less an amount equal to the par amount of any obligations of foreign governments held by the United States on July 1, 1920, and (2) the interest which would have been payable during the fiscal year for which the appropriation is made on the bonds and notes purchased, redeemed, or paid out of the sinking fund during such year or in previous years.

The Secretary of the Treasury shall submit to Congress at the beginning of each regular session a separate annual report of the action taken under the authority contained in this section.

(b) Sections 3688, 3694, 3695, and 3696 of the Revised Statutes, and so much of section 3689 of the Revised Statutes as provides a permanent annual appropriation of 1 per cent of the entire debt of the United States to be set apart as a sinking fund, are hereby repealed.

Senator HARRISON. Does that period of 25 years date from 1920 or from 1922?

The CHAIRMAN. From July 1, 1920.

Senator HARRISON. So we have 20 years now to run?

The CHAIRMAN. It will be six years on July 1, 1926, since it began.

Senator KING. Regardless of any statutory provision, the Treasury recommendations contemplate that there shall be enough revenue raised to meet the demands of the sinking fund as provided in section 6 (a) of the Victory Liberty loan act and no more.

Secretary MELLON. Well, there are——

Senator KING (continuing). If you will pardon me for a moment. Of course I do not mean by my question to exclude whatever we might receive from foreign sources, but by way of taxation you have only provided in your recommendation for a sufficient amount to meet the requirements of the sinking fund.

Secretary MELLON. Exactly.

Senator KING. And that amounts to $250,000,000.

Secretary MELLON. It amounts to $306,000,000 on account of a secondary credit. That is, interest on bonds that have been retired.

The CHAIRMAN. The original amount was $384,000,000, but $253,000,000 is the correct amount, and the balance is interest on bonds which have been retired from a sinking fund.

Senator REED of Pennsylvania. If the revenue is reduced by $330,000,000 that contemplates no amount for bond retirement except the sinking fund and what we may get in from foreign governments.

Secretary MELLON. Yes.

Senator WADSWORTH. Would the aggregate of that be about $500,000,000 a year?

Secretary MELLON. It would be well up to $500,000,000 in the coming year.

Senator WADSWORTH. That is approximately the annual reduction.

Secretary MELLON. Yes.

Senator SIMMONS. I did not understand exactly what you said.

Secretary MELLON. That is, that this statutory requirement of sinking fund plus our expected receipts from the foreign-government settlements will provide approximately $500,000,000 debt retirement.

Senator SIMMONS. That is, for application to the whole indebtedness of the United States?

Secretary MELLON. Yes.

Senator SIMMONS. You are not proposing, then, to apply any money coming into the Treasury through taxation of the people to retirement of this debt, except that part which is set aside as sinking fund under this act?

Secretary MELLON. That which is set aside as sinking fund plus any receipts from foreign governments.

Senator SIMMONS. I understand that.

Undersecretary WINSTON. Of course, I might explain, if a surplus exists it would automatically go into debt reduction. But this bill, considering the amount of loss of revenue involved, will not leave any surplus to go into debt reduction.

Senator SIMMONS. I do not know, Mr. Winston, so much about that; and I do not know that the Treasury knows so much about that so far in advance. It may have some idea of it for the next six months, but our estimates from the Treasury Department have been of such varied character that I think it is quite reasonable for us to suppose that you may make a mistake about that so far as estimates are concerned, as well as any layman. You have made a good many mistakes in your prognostications about what the surplus would be.

Secretary MELLON. You can scarcely characterize them as mistakes, I might suggest.

Senator SIMMONS. Well, they are misestimates.

Undersecretary WINSTON. That is a big item. We have gone into that, and that is a realization of capital assets. I think the change in railroad receipts was the biggest item of this estimate. Those railroad receipts meant that instead of spending money on the railroads, which the director general cut off, we commenced getting money from loans to railroads. But now those loans have gotten down to where there will be very little more to collect.

Senator SIMMONS. Did not you know in advance how much you were going to collect from the railroads?

Secretary MELLON. Oh, no; because conditions improved.

Senator SIMMONS. Did not that indebtedness become due at a certain time?

Undersecretary WINSTON. Oh, yes; but the railroads paid in advance of the due date. The indebtedness by the railroads was payable on or before certain times.

Secretary MELLON. You must remember that money conditions in the market changed, so that the Director General of Railroads realized on securities which we could not have realized on before, and therefore that resulted in a return of funds to the Treasury that could not have been anticipated. But, as Mr. Winston says, we have now pretty well exhausted any expectations from that source, because there is only a small amount remaining to be paid.

Senator SIMMONS. Let me ask you a question right there: When will the first Liberty bonds become payable, I mean at the option of the Government?

Undersecretary WINSTON. In 1928——

Senator REED of Pennsylvania (interposing). Oh, no; he said at the option of the Government.

Senator SIMMONS. Do not some of them come due in 1927?

Undersecretary WINSTON. Oh, at the option of the Government you added. Yes; they do.

The CHAIRMAN. I should like to have you put in our record at this point the amount of Liberty bonds outstanding and when they fall due.

Senator SIMMONS. Yes; all of them.

Undersecretary WINSTON. All right. They are as follows:

Title	When redeemable or payable
First Liberty loan:	
3½ per cent bonds of 1932-1947	Redeemable on or after June 15, 1932; payable June 15, 1947.
Convertible 4 per cent bonds of 1932-1947	Do.
Convertible 4¼ per cent bonds of 1932-1947	Do.
Second convertible 4¼ per cent bonds of 1932-1947.	Do.
Second Liberty loan:	
4 per cent bonds of 1927-1942	Redeemable on or after Nov. 15, 1927; payable Nov. 15, 1942.
Convertible 4¼ per cent bonds of 1927-1942	Do.
Third Liberty loan: 4¼ per cent bonds of 1928	Payable Sept. 15, 1928.
Fourth Liberty loan: 4¼ per cent bonds of 1933-1938.	Redeemable on and after Oct. 15, 1933; payable Oct. 15, 1938.
Treasury bonds:	
4¼ per cent bonds of 1947-1952	Redeemable on and after Oct. 15, 1947; payable Oct. 15, 1952.
4 per cent bonds of 1944-1954	Redeemable on and after Dec. 15, 1944; payable Dec. 15, 1954.

Secretary MELLON. The biggest problem that the Treasury has is to meet these third Liberty loan bonds, which do not have a call date, but which mature in 1928.

Senator WATSON. What is the amount of them?

Undersecretary WINSTON. Nearly three billions of dollars.

Senator SIMMONS. That is a fixed date?

Undersecretary WINSTON. Yes; and the only fixed date bonds that we have.

Senator SIMMONS. When are they due?

Undersecretary WINSTON. September 15, 1928.

Senator SIMMONS. You mean to say by "fixed date" that they are absolutely due on that date?

Undersecretary WINSTON. Yes, sir. And I might suggest that it is a very big obligation to meet.

Senator SIMMONS. There is no option to extend them longer?

Undersecretary WINSTON. No.

The CHAIRMAN. The amount issued was $4,175,650,050, but the amount retired as of June 30, 1925, represents $1,290,272,700, leaving a balance of $2,885,377,350, but some more have been retired since.

Senator SIMMONS. I have no idea the Government will have any trouble refunding them.

Undersecretary WINSTON. But we have to have a good market to refund them in, and we have to keep our debt structure in good shape so that we will have a good market to refund them in. If we cut down our sinking fund our bonds are less valuable.

Senator REED of Pennsylvania. You are applying your sinking fund right along to the purchase of third Liberties?

Secretary MELLON. Yes; as we can.

The CHAIRMAN. And you have purchased already a total of $1,753,176,900.

Senator REED of Pennsylvania. What is the average purchase price to-day?

Undersecretary WINSTON. I have not the figures here, but we have a margin of about $8,000,000 between par and the price we actually paid for the bonds.

Senator REDD of Pennsylvania. That is, counting all purchases up to date?

Undersecretary WINSTON. On purchases under the sinking fund.

Senator REED of Pennsylvania. And you have paid above par?

Undersecretary WINSTON. We paid below par, in that our total aggregate purchases through the fiscal year 1925 were $1,423,000,000 of bonds purchased. but the amount we paid for those bonds was $1,415,000,000.

Senator SIMMONS. So far as the sinking fund is concerned the amount of sinking fund to amortize a certain sum of indebtedness depends upon the length of time of maturity. Your sinking fund you are setting aside is based upon 25 years' maturity.

Undersecretary WINSTON. That is, from the date of its creation it was supposed to retire one-half of our debt.

Senator SIMMONS. If you were to estimate the amount of sinking fund based upon 30 or 40 years' maturity, why, of course, it would not require such a large sinking fund.

Undersecretary WINSTON. That is quite obvious.

The CHAIRMAN. In the next five and a half years the total debt maturities, to November 30, 1920, we will say, is $6,182,469.286.

Senator WATSON. How much of that is compulsory?

The CHAIRMAN. It is all compulsory.

Undersecretary WINSTON. I have the exact figures to December 31, 1925.

The CHAIRMAN. These are public debt maturities to November, 1930.

Undersecretary WINSTON. That has been changed slightly. It is $6,034,000,000 as of the 1st of January, 1926.

The CHAIRMAN. That is on account of payments that have been made in December.

Undersecretary WINSTON. Yes.

Senator REED of Pennsylvania. Your present program contemplates the payment of about $2,500,000,000 during these five years, and the refunding of about $3,500,000,000.

Undersecretary WINSTON. It does not go quite that far, because it is desirable to always have some maturities in every quarter at tax-payment dates. So a part of these will be rolled over from year to year. We should not have any year in which we have not maturities coming in.

Senator REED of Pennsylvania. Well, I call that refunding. Between your sinking fund and foreign debt payments you have about a quarter of a billion dollars a year coming in in the next five years.

Undersecretary WINSTON. Yes.

Senator REED of Pennsylvania. That means that you can redeem or retire $2,500,000,000 of public debt between now and November 30, 1930?

Undersecretary WINSTON. Yes; that is right.

Senator REED of Pennsylvania. And necessarily you will have to carry over by refunding about $3,500,000,000.

Undersecretary WINSTON. Yes, sir.

Senator KING. How do you care for your short-time loans?

Undersecretary WINSTON. By rolling them over. We had maturing last December $480,000,000, and we issued new securities of $450,000,000 maturing the following December.

Senator SHORTRIDGE. Is that what you mean by "rolling over"?

Undersecretary WINSTON. Yes.

Senator WATSON. At the same rate of interest?

Undersecretary WINSTON. It depends, but on these particular bonds I believe the rate of interest was——

Senator WATSON (interposing). You spoke of $450,000,000.

Secretary MELLON. The rates paid, of course, depend on market conditions at the time.

Undersecretary WINSTON. But Senator Watson wanted to know the particular rates paid on maturing obligations.

Senator WATSON. Yes; what were they in fact at that time?

Undersecretary WINSTON. They were 4⅜ per cent interest on some notes that were maturing, and 3 per cent interest on some certificates that were maturing.

Senator KING. Without expressing an opinion would it be wise to fund some of these short-time loans, which must be paid within the period mentioned by Senator Reed, by extending them, say, 20 years or more, and then apply the sinking fund to the payment of the bonds as they mature?

Secretary MELLON. That depends upon market conditions, as to the rate of interest. If there happened to be a period where a low rate on the longer time could be obtained then that would be good policy. But in our late meeting of maturities the rates have not been such that we could put out any long-term securities. We have in the past two or three years made two issues of long-term securities.

Undersecretary WINSTON. We sold in December and March of last year something over a billion dollars of 4 per cent bonds, I believe $1,047,000,000——

Senator KING (interposing). Payable when?

Undersecretary WINSTON. Payable in 1954, but callable in 1944.

Senator KING. Do you have to pay so high a rate of interest as that for long-term bonds?

Undersecretary WINSTON. We did. They sold just above par. They have gone up since, when the whole market went up. They were about on the market when we sold them.

Senator KING. Does the existing statute authorize the Secretary of the Treasury to refund these maturing obligations at such rate or rates of interest as he pleases?

Undersecretary WINSTON. I think we can not go above 4¼ per cent.

Senator KING. And does the statute fix the maximum period within which payments shall be made?

Undersecretary WINSTON. No; I do not think they do.

The CHAIRMAN. You see, as long as State bonds are selling for what they are, buyers are not going to pay any very much higher figure for Government bonds.

Senator KING. Yes; but——

Senator REED of Pennsylvania (interposing). The rate must go over 4¼ per cent, because Secretary Houston had to pay as high as 6 per cent on some bonds he issued.

Undersecretary WINSTON. There are three classes of obligations—bonds, notes, and certificates. The limit of interest applies to the bonds, but does not apply to the notes nor to the certificates, because we must pay what the current rate is on them.

Senator KING. I see. Generally speaking, our floating indebtedness is about $6,500,000,000.

The CHAIRMAN. Within the next five years.

Senator REED of Pennsylvania. That includes the third Liberty loan.

Undersecretary WINSTON. We have our temporary borrowings. That is, our temporary Treasury certificates have been as low as 2¾ per cent, and in carrying over in these temporary borrowings on Treasury certificates the rate of interest paid generally has been low. It has been less than if we had funded on a long-time basis.

Senator KING. If you can do that you better handle them the other way.

Secretary MELLON. Except you have to take care of large maturities. It is necessary not to have too great an amount coming due at one time, which might disturb the money market and require a higher rate of interest.

Senator KING. Does not the statement which you have just made with respect to high rate of interest, or relatively high for long-term

loans, maturing in 1954 or 1960, contravene the usual procedure or usual happenings in continental countries, and in the United States, where you float loans, the obligation maturing in 20 years or 30 years or 40 years in the future?

Secretary MELLON. You are speaking of a higher rate of interest on long-term loans, but that is relative to the short borrowings, which are at a low rate. The intermediate rates would be still higher. In other words, for a 5-year loan we would pay more money than for a 20-year loan; I mean, for a loan not redeemable for 20 years.

Senator KING. I am surprised at that statement, I must confess.

Senator SIMMONS. Mr. Winston, maybe you have the figures. Can you tell us how many of the 3½ per cent Liberty bonds that were issued and afterwards made convertible into higher interest-bearing bonds are still unconverted, still held by purchasers?

Undersecretary WINSTON. There are $1,409,000,000 of first Liberty oan bonds outstanding; that is, 3½ per cent full tax exempt.

Senator SIMMONS. And what was the total issue?

Undersecretary WINSTON (continuing). And $532,000,000 have been converted into 4¼ per cent bonds.

Senator SIMMONS. And that means a billion and how many million dollars?

Undersecretary WINSTON. Taking it roughly, the three-quarters are still where they were and the one-quarter has been converted.

Senator SIMMONS. That is because those bonds were totally exempt from taxation.

Undersecretary WINSTON. Yes.

Senator SIMMONS. And the other bonds are subject to a surtax?

Undersecretary WINSTON. That is correct.

Senator SIMMONS. Mr. Mellon, what reason is there why that surtax on the income from those 4½ and 4¼ Liberty bonds should continue?

Secretary MELLON. Why it should continue, did you ask?

Senator SIMMONS. Yes; why it should not be repealed.

Secretary MELLON. Do you mean that they should be made free of tax?

Senator SIMMONS. They are taxable now.

Secretary MELLON. They are free of a normal tax.

Senator SIMMONS. I know, but I am talking about the surtax. There is a surtax imposed upon all these Liberty bonds, except the first issue of 3½ per cent, and we gave to the holders of those 3½ per cent bonds the privilege of converting them into the higher interest-bearing bonds.

Secretary MELLON. Yes.

Senator SIMMONS. But it turns out that only about one-fourth of the holders of those bonds have availed themselves of that privilege.

Secretary MELLON. Yes.

Senator SIMMONS. And Mr. Winston says that is because the one is subject to a tax and the other is not subject to a tax, and I think that is the reason, and I am asking you why, because I have never known exactly why, we put a surtax on the income from those bonds? It makes a very anomalous situation.

Undersecretary WINSTON. The mistake we made was that we ever issued any bonds that were tax exempt and lost control of the situation.

Senator SIMMONS. Oh, that has been the law from time immemorial in this country so far as tax-exempt bonds are concerned. This is the first time the Government, so far as I know, ever taxed income from its own bonds. No State is doing it, and the Government is not doing it except as to the second, third, and fourth issues of Liberty bonds.

Undersecretary WINSTON. The effect of not taxing them is to put them in the hands of the wealthy to avoid paying the expenses of the Government.

The CHAIRMAN. What we decided here when it was requested of us by the Secretary of the Treasury.

Senator SIMMONS. Mr. Chairman, I do not want to discuss at this time the question of tax-exempt securities. I am simply talking about the fact that we find here a special issue of war bonds the income from which is subject to tax, while all the balance of the Government bonds now outstanding are not subject to the surtax, and we have got to refund these bonds within a short time; and when we refund them we want to get a lower rate of interest. I am just suggesting this as a matter worthy of consideration.

The CHAIRMAN. If you will look up this matter you will find that Secretary McAdoo when he requested that these be made taxable for surtaxes but not for normal tax, he said it would prevent large corporations and banks of this country from escaping taxation by buying these bonds and holding them as security, which they do now.

Senator SIMMONS. They can buy State bonds now that are in that class.

Senator JONES of New Mexico. Let me suggest at the present time that all these institutions to which the chairman has just referred do not pay any surtax on any of these bonds. I agree with the statement of the chairman that at the time it was to accomplish just what he has said, but owing to the change in the law of taxation affecting corporations that purpose has been wholly lost sight of.

The CHAIRMAN. We get a tax now of 12½ per cent.

Senator JONES of New Mexico. Oh, now, you do not get 12½ per cent on them.

Senator REED of Pennsylvania. No Liberty bond held by any corporation pays any tax to the United States, because the corporation pays only a normal tax of 12½ per cent. So Liberty bonds in the hands of any corporation are tax free. The 3½ per cent bonds must be held by individuals.

The CHAIRMAN. It is reached under something else.

Senator REED of Pennsylvania. No; they do not consider Liberty bond interest.

Undersecretary WINSTON. Tax-exempt securities in our debt structure are probably less than one-tenth of the total, not the reverse.

Senator JONES of New Mexico. Has the Treasury Department ever ascertained how much tax the Government is getting on these bonds or any certificates of indebtedness?

Undersecretary WINSTON. I am not sure whether there are not some figures in the present income tax returns which show that. It was put into the return for 1925 income by the 1924 law that they should report.

Senator JONES of New Mexico. I wish that you would put into this record the amount of tax received on this indebtedness of the Government.

Undersecretary WINSTON. It has been our experience that these statistics, returned solely for information in a man's income-tax return, are very unreliable because a great many people do not pay any attention to them. So I do not know whether the figures are correct or not, but there are some figures in the statistics of income.

Senator JONES of New Mexico. What are those?

Undersecretary WINSTON. These figures, which are given us and which I do not suppose are correct, are partially exempt securities held, a billion and a half dollars.

Senator JONES of New Mexico. The taxing part would be only the surtax on interest of $1,500,000,000.

Undersecretary WINSTON. That is right.

Senator JONES of New Mexico. Have you any means of estimating how much that would amount to?

Undersecretary WINSTON. No. Then, too, of course, we do not know what brackets those would come under, that income would come under, so what the tax would be is almost impossible to ascertain.

Senator JONES of New Mexico. I think I may state that so far as my investigations have gone and according to my recollection at this time the amount of tax which the Government receives on all these securities is not over about $5,000,000 a year.

Senator KING. Do you mean tax-exempt securities?

Senator JONES of New Mexico. On the partially tax-exempt securities.

Secretary MELLON. I do not think there are any statistics from which you could draw substantial conclusions.

Undersecretary WINSTON. The interest actually received on those $1,500,000,000 of bonds which were reported, and which we do not believe represent anywhere near all of them, was $70,000,000.

Senator JONES of New Mexico. And then the surtax on that $70,000,000 is all that you get?

Undersecretary WINSTON. Well, as to the surtax on $70,000,000, they must be held in very small hands if the surtax would not net $5,000,000 on $70,000,000.

Senator REED of Pennsylvania. And the situation as to that will be very much changed on the 2d of July next because of the $55,000 exemption of any holder of Liberty bonds ceases on that date, and only $5,000 become tax free after that time. So that our yield on income tax from Liberty bond interest ought to go up very much after the 2d day of July next.

Senator JONES of New Mexico. How much would it have to go up to make a difference of three-quarters of 1 per cent on the indebtedness?

Senator REED of Pennsylvania. I think you can calculate that on the relative value of the 4½ per cent and the tax free 3½ per cent bonds.

Senator JONES of New Mexico. How much does that amount to?

Undersecretary WINSTON. I did not get your question.

Senator JONES of New Mexico. Assuming that if these tax obligations were wholly tax exempt and that we could carry them at 3½ per cent, how much saving to the Government would there be?

Secretary MELLON. You could not carry them at 3½ per cent. These 3½ per cent bonds are below par. In other words, it takes more than 3½ per cent on a tax-exempt security.

Senator Jones of New Mexico. How much are they below par?

Secretary Mellon. They are 99 and something. And I might add that they are the only security we have that is below par.

Senator Jones of New Mexico. They are nearly par, are they not?

Secretary Mellon. Yes.

Senator Jones of New Mexico. They are quoted at about 99.2530.

Secretary Mellon. Yes; and they were above par until there was a prospect of tax reduction.

Senator Jones of New Mexico. And all these other obligations were more above par than they are now.

Secretary Mellon. You can purchase tax-free securities, like the city of Philadelphia or the city of Pittsburgh and other cities, to-day that will yield something over 4.3 per cent.

Senator Jones of New Mexico. Yes; but do not you consider a tax-exempt bond of the United States Government more valuable than a tax-exempt bond issued by the city of Philadelphia, or the city of Pittsburgh, or any other city?

Secretary Mellon. Not necessarily.

Senator Jones of New Mexico. Does not the market so consider them?

Secretary Mellon. No.

Senator Jones of New Mexico. Has it not always been so, that a Government bond will sell for a lower rate of interest than the bond of any municipality in the United States?

Secretary Mellon. Well, to answer that I will say that the bonds of the State of Pennsylvania nearly a year ago were sold on the basis of about 3.80 per cent. They go very well.

Senator Simmons. I think my State made a sale recently at 4.25 per cent.

The Chairman. And probably less than that.

Senator Reed of Pennsylvania. Is not the contrast, Senator Jones, you are trying to bring out very well expressed by a comparison of the prices of first Liberty 3½'s, which at present are selling for 99.2030, with the Treasury bonds of 4 per cent issued last year, which ran for about the same time, and which are selling now at about 102.50?

Secretary Mellon. Yes.

Senator Reed of Pennsylvania. In other words, tax-free bonds are selling at an interest basis of about 3.60 per cent, while tax bonds for about the same length of time which the Treasury is selling are at about 3.75 per cent. That expresses the market value of that exemption from surtax to-day.

Secretary Mellon. Yes.

Senator Reed of Pennsylvania. But if you made all these subsequent Liberty issues totally tax exempt, then would not every rich individual proceed to buy those, and in great numbers? And it would further have the effect of making a very large amount of tax exempt bonds on the market.

Undersecretary Winston. That changes the value. It takes away the scarcity value.

Senator Reed of Pennsylvania. What I am arriving at is this, that in order to get about fifteen one-hundredths of 1 per cent in

interest you would be creating a tax-free refuge for wealthy men of about $10,000,000,000.

Secretary MELLON. Yes.

Senator REED of Pennsylvania. I think the Government would lose many times what it obtains the other way.

Secretary MELLON. At any rate these bonds that are outstanding are redeemable after a certain period, but it would take sometime before you could make the change that you are suggesting.

Senator JONES of New Mexico. I am not suggesting any given time within which it should be done, but it appears now that these bonds are being held by corporations in the main, and that they are totally exempt in the hands of the corporations; that we are getting very little tax return upon these bonds which are outstanding, and yet we are paying a much higher rate of interest than we would have to pay if they were wholly tax exempt, and it seems to me that we ought either to work to the end of having them all wholly tax exempt in the hands of everybody, or else change the law in some way so as to make these corporations pay some tax upon these bonds.

The CHAIRMAN. May I suggest that if that is done with these bonds, if they are made tax exempt, they will be purchased by men who perhaps pay the full 20 per cent under the bill, or whatever their maximum may be.

Senator JONES of New Mexico. I think we can guess the future by our present experience.

The CHAIRMAN. Oh, no, not at all. They do not buy them now because they are taxable, but if they were tax exempt they would buy them.

Senator SIMMONS. I think the investigation made some time ago shows that rich men hold mighty few of them.

Secretary MELLON. The evil of the two classes is that you do not have a uniform system of taxation. It would be very much better if all securities were equally taxable.

Senator SIMMONS. And you are assuming that all of these bonds ought to be subject to taxation?

Secretary MELLON. Yes.

Senator SIMMONS. You say it would be better.

Secretary MELLON. Yes.

Senator SIMMONS. But if they are not all subject to taxation, if ninety-nine one-hundredths of them are tax exempt, what reason is there why that one one-hundredth of them should be taxed?

Undersecretary WINSTON. You have the thing reversed because the larger amount is taxable.

Senator SIMMONS. I am talking about taking all of the nontaxable securities of the United States, State, municipal, and United States Government. There is not one in a hundred bonds that is subject to tax; of all that vast amount of bonded indebtedness of this country, none of it is subject to taxation except these Liberty bonds, these bonds that we put on the people during the war.

Secretary MELLON. If these Liberty bonds had been made tax exempt entirely, throughout the $20,000,000,000 of them, we would have had very wealthy men buying into them and we would not have saved anything in interest.

Senator SIMMONS. Every wealthy man did not appeal for tax-exempt securities, and your investigation shows it.

Secretary MELLON. There were not enough of them.

Senator SIMMONS. Well, if people did not buy State and city bonds either, if wealthy people, men of large means, they could make more money by investing their funds in some other way, than by investing it in tax-exempt securities.

Undersecretary WINSTON. Let me say this: A comparable basis as to what the value of these tax-exempt securities may be considered to be, or as to what the privilege is, is shown a little more accurately I think by the market price and the return therefor on the first Liberty 3½'s and the first Liberty 4¼'s, which are exactly the same bonds except as to interest rate. A year ago the difference in value of return between these was about three-quarters of 1 per cent. To-day it is less than one-half of 1 per cent. That means that people who are investors in these securities consider that the surtax is going to be reduced, and the value of the tax exemption is decreased. So they get out of these bonds and put their money into productive business, and that is just what they have been doing. And the reason why these bonds have gone below par—and they are the only bonds we have that are below par—is that there is a belief there will be a tax reduction of a certain figure and the people are getting out of these bonds.

Secretary MELLON. Take the city of Philadelphia, which in the spring of 1924 made an issue I think somewhere about $10,000,000 of bonds. They were sold to the investor to obtain a yield of 4.15 per cent. About a year ago the city of Philadelphia sold $15,000,000 of the same kind of bonds, carrying the same rate of interest, and they were bought so that the investor obtained a fraction over 4.30 per cent, representing the difference between 4.15 and 4.30. That difference is on account of the anticipation of lower surtax rates.

Senator SIMMONS. You a little while ago said that the rate of interest we would have to pay would depend very much upon money conditions.

Secretary MELLON. Yes.

Senator SIMMONS. Do not these money conditions determine more than the little tax what bonds are worth?

Secretary MELLON. No; the money conditions during the past year, for that length of time, did not represent any material change. They remained practically stationary.

Undersecretary WINSTON. Senator Simmons, the rate of taxable bonds and tax exempt bonds will show that tax-exempt bonds have gone down more than taxable bonds.

Senator SIMMONS. This is plain, is it not, that when the second Liberty bonds—or are they the third Liberty bonds that fall due in 1928?

Undersecretary WINSTON. The third Liberty bonds.

Senator SIMMONS. When they fall due in 1928 and you refund them would the tax provision of the present law apply to those refunded bonds?

Undersecretary WINSTON. Yes.

Senator GEORGE. May I ask this question: Is not the objection or evil, if there be an evil in the tax-exempt security, due to the extraordinary high surtaxes, or whatever case that rate is classed; and is not

that evil more a symptom, and the farther away you get from these high surtaxes do not you come back down to a normal basis where the Government can with perfect safety abide by the generally established policy of issuing nontaxable bonds?

Secretary MELLON. Of course that works both ways. The Government does not then get so great an advantage in price in selling nontaxable bonds. I think you have stated correctly that the lower surtax removes the evil of——

Senator GEORGE (interposing). And the more that is reduced the more you minimize the actual evil, if that be an evil.

Secretary MELLON. Yes.

Senator JONES of New Mexico. Let me ask you, Mr. Winston: These wholly tax-exempt bonds were above par for quite a while, were they not?

Undersecretary WINSTON. Yes, sir.

Senator JONES of New Mexico. When they began to fall in price did not the second 4¼'s also fall in price?

Undersecretary WINSTON. There has been some drop in the prices, Senator, but the spread between the bonds had been greater. I mean comparatively the tax-exempt 3½'s have gone further than the other bonds, and I can prove that to you accurately by showing that the spread between the 4¼ taxable first Liberty and the 3½ nontaxable first Liberty has narrowed.

Senator JONES of New Mexico. To what extent?

Undersecretary WINSTON. I say the return has narrowed from about three-quarters of 1 per cent to less than one-half of 1 per cent, and that is the spread.

Senator REED of Pennsylvania. Is it not less than one-quarter of 1 per cent?

Undersecretary WINSTON. I wish I had brought the statement with me, because it shows exactly how much it has narrowed. But I have not the statement with me at this time.

Senator JONES of New Mexico. I wish you had brought it with you, because my recollection is that there has been about as much decline in the price of the 4¼ per cent bonds as in the 3½ per cent bonds.

Undersecretary WINSTON. It is quite strikingly the other way round. Of course when we deal with Government long-time bonds even the slightest change is quite material because the amount is so large. It is not like shifting an individual stock up 10 or 12 points.

Senator JONES of New Mexico. I should like to get the figures put in the record.

Undersecretary WINSTON. If I may insert in the record the spread between those bonds two years ago, a year ago, and to-day I shall be glad to do it.

Senator JONES of New Mexico. I would like to make this request of Mr. Winston, that you have prepared a statement of the amount of the sinking fund which is applicable during this year to the reduction of indebtedness, and the amount next year, and next year, and so on, for the next 40 years—just that sinking fund.

Senator WATSON. That would be purely an estimate.

Senator JONES of New Mexico. I think not. It is applying an amount of the sinking fund each year to the reduction of the debt on this cumulative sinking fund.

Undersecretary WINSTON. There is an indefinite factor in it in the interest on purchases each year. We do not know what bonds we are going to buy next year. We may buy a 5 per cent bond or a 3½ per cent bond.

Senator WATSON. The first year it started with $250,000,000, did it not?

Undersecretary WINSTON. $253,000,000 and something.

The CHAIRMAN. That is without the cumulative interest, of course.

Senator WATSON. And it is practically $310,000,000 this year.

Senator HARRISON. Mr. Chairman, I hope that the Secretary or Mr. Winston will prepare and give to the committee, for the purpose of the record, these various estimates, so that we can see how far wrong the Treasury Department was on the surplus that was accumulated from the various sources by virtue of the 1921 revenue law and the 1924 revenue law.

Senator REED of Pennsylvania. The same point was made two years ago, you remember.

Senator HARRISON. Yes.

Undersecretary WINSTON. We would naturally estimate those things through Mr. McCoy. I could state them for you, but Mr. McCoy is right here.

Senator JONES of New Mexico. I think we found in some investigation that Mr. McCoy had very little to do with it for a while.

Undersecretary WINSTON. I do not think that condition exists to-day; I am sure it does not.

Senator JONES of New Mexico. It may not.

Senator HARRISON. I hope you are as far wrong in your estimate this time as you were the last time, Mr. Winston.

The CHAIRMAN. Of course, now we have no war supplies to sell; we are now down to bedrock and that source of income ceases.

We will meet to-morrow morning at 10 o'clock, and Secretary Mellon will be here to-morrow evening. We will also meet to-morrow afternoon at 2 o'clock.

Secretary MELLON. You are expecting me, then, Mr. Chairman, at 2 o'clock?

The CHAIRMAN. Yes.

(Whereupon, at 11.45 o'clock a. m., the committee adjourned to meet at 10 o'clock a. m. to-morrow, Tuesday, January 5, 1926.)

REVENUE ACT OF 1926

TUESDAY, JANUARY 5, 1926

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

The committee met in room 310, Senate Office Building, at 2 o'clock p. m., pursuant to adjournment, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Watson, Reed of Pennsylvania, Stanfield, Wadsworth, McKinley, Shortridge, Simmons, Jones of New Mexico, Gerry, Harrison, King, and George.

Present also: The Secretary of the Treasury (Mr. Mellon) and the Undersecretary (Mr. Winston).

The CHAIRMAN. The committee will come to order. We will proceed. Yesterday, I think it was, Senator Simmons that requested certain estimates to be furnished by the Secretary of the Treasury.

Undersecretary WINSTON. It was in connection with the accuracy of our estimates.

The CHAIRMAN. And I was going to ask the Secretary if he had prepared the statement or had the information at hand so that he could give it at this time. He states that he has. Now, Mr. Secretary, we will be glad to hear what you have to say.

STATEMENT OF HON. ANDREW W. MELLON, SECRETARY OF THE TREASURY—Continued

Secretary MELLON. This was in regard to the question that was raised yesterday concerning the Treasury estimates of surplus.

The CHAIRMAN. In the past years.

Secretary MELLON. In the past years. The question was raised yesterday at the hearing as to the accuracy of Treasury estimates of governmental receipts and expenditures. There are two elements which affect the net result: An increase or decrease in the receipts and a decrease or increase of the expenditures. When sudden or violent changes occur in the industrial conditions of America, our estimates are sometimes put out of line. In the fiscal year 1924, for example, there was great improvement in the money market. Railroad securities heretofore acquired by the Government could be refunded at lower interest rates by the railroads and were therefore paid off or purchased by brokers. The Director General of Railroads and the Interstate Commerce Commission had made estimates of a net cash outgo in the railroad account. By reason of change in monetary conditions, this net cash outgo was changed to a net cash income, making a difference of some $120,000,000 in the estimates. In 1925

the customs receipts were estimated within one-half of one per cent, miscellaneous internal revenue within even less error than this, but the income taxes were underestimated 6 per cent. The Treasury had not fully appreciated the great improvement in business conditions.

The practice of obtaining estimates in the Treasury now in force is to approach the subject from various viewpoints so as to insure the greatest probable degree of accuracy. The customs receipts are estimated by the director of customs who is the practical operating man; by Mr. McCoy, the the Government actuary; and by the head of the section of statistics of the Treasury. Income and miscellaneous taxes are estimated by Mr. McCoy, the head of the section of statistics, and by Mr. Nash, assistant to the Commissioner of Internal Revenue. The last is the practical man. The estimates of the head of the section of statistics are based on business conditions and industrial cycles; for example, the propserity of corporations in one year is reflected by the dividends received by their stockholders in later years. Mr. McCoy has his own method of figuring. All of the estimates are gathered together, and, after conferences, the differences are threshed out and the most probable figures are selected.

Senator JONES of New Mexico. Who decides which are the most probable figures?

Secretary MELLON. It is the consensus of opinion. Approaching as we do the subject from a practical and two different theoretical viewpoints, I think we achieve as accurate a result as is obtainable.

For the past three or four years we have been gradually disposing of our unusual capital items, and the effect of these items on our revenue for the future can be much more accurately determined There are not likely to be very material payments on the remaining obligations we hold of the railroad companies, since nearly all of the strong companies have got out of debt to the Government, and the War Finance Corporation, whose return of cash advances has represented some $200,000,000 in the last three years, is now completing its liquidation. We have made more certain our estimates of taxes and there is less unusual revenue to influence our Budget. We have estimated our taxes based on a high degree of prosperity in the country. A radical change in conditions would probably be down rather than up, with the usual swing of the industrial cycle. I feel, therefore, that our estimates, while justified, can not safely be considered as too low.

I say this particularly because from now on the Government will have to rely almost exclusively on current revenues and can not continue to fall back on the realization of capital assets which represented Government expenditures in past years. For example, the sale of surplus war supplies, railroad securities, and the liquidation of the War Finance Corporation alone accounted for $528,000,000 of our receipts in the past three years. There are no more surplus war supplies, the War Finance Corporation is practically liquidated, and, as I have said, most of the strong railroads have paid their debts to the Government and we are left holding the obligations of the weak roads.

Looking at the other side of the picture, I see very little opportunity to decrease Government expenditures. On the contrary, we must adopt a public buildings program which has been neglected since before the war. The country itself is growing and the Government

must necessarily expand with it. I wish to impress upon this committee, as seriously as I can, that the reduction in revenue carried in the House bill is as far as it is safe to go.

The Chairman. You do not refer there to the deficit of $49,000,000 of the Post Office.

Secretary MELLON. No.

The CHAIRMAN. Are there any other statements that you now desire to make?

Undersecretary WINSTON. I wish to answer the question that Senator Jones asked me yesterday about the return on the two classes of Liberty bonds.

Senator HARRISON. Now before you get to that, Mr. Winston.

Undersecretary WINSTON. Yes.

Senator HARRISON. Have you got some figures there so that the record will show just what the estimates of the department were on the 1921 and 1924 revenue bills, and just what was actually received, to show the difference in those estimates?

Undersecretary WINSTON. No; I have not.

Senator HARRISON. Could that be secured very easily so we could see? I don't know whether I remember correctly, but it seems to me that there was a very great difference between the estimates and what was actually received.

Senator McLEAN. I think that is in the record over in the House.

Undersecretary WINSTON. That appears to be in the hearings on the 1924 bill. This was all in the 1924 hearing, they tell me, at page 149 of the Senate hearings last year.

Senator HARRISON. Well I notice in the hearings, Mr. Winston, that you stated that in 1923 there was about 11 per cent difference between the estimates and the results. Is that correct?

Undersecretary WINSTON. Of the total estimates and total results?

Senator HARRISON. Yes.

Undersecretary WINSTON. Or just income tax? I am not sure which?

Senator HARRISON. No; that was based on the whole, I take it. Here is your statement on page 138 of the hearings on the revenue act of 1924:

> Now, on these estimates of receipts for the current fiscal year of 1921, the estimate was within 2 per cent of the actual result. In 1922 they were within 3.5 per cent of the actual, and in 1923 about 11 per cent of the actual.

It would seem that 11 per cent is a pretty big difference. And then further on you make the statement:

> There is a big item in expenditures.

You were talking about railroads.

> There is something that the Budget could not control. There were $284,000,000 estimated expenditures. The actual net expenditures were $15,000,000. The other big item, of course, is the $350,000,000 customs receipts which ran up to $562,000,000, * * *

You missed it some two hundred million dollars there. [Continuing reading:]

> * * * and the income and profits tax, which was $1,300,000,000 and ran up to $1,679,000,000.

A difference of $379,000,000.

The CHAIRMAN. The law was changed after these estimates were made.

Undersecretary WINSTON. Mr. McCoy calls my attention to the fact that you changed the law under which the customs receipts were collected after the estimates were made, and necessarily there must be a different revenue.

Senator HARRISON. That is exactly why I think the record here ought to show what the estimates were and what the actual results were so as to show the difference between the estimates and the result, if you could get those figures for us.

Undersecretary WINSTON. And the explanation of the difference between the two?

Senator HARRISON. Yes; and the actual amount, the actual difference.

The CHAIRMAN. Get the actual amount and the actual difference.

Undersecretary WINSTON. Yes; I will get that.

Senator GERRY. And I suggest that it go right in the record here.

The CHAIRMAN. If you can get it out in time.

Undersecretary WINSTON. Yes; that will not take us long.

Senator GERRY. Then we will have the whole thing in its natural sequence.

The CHAIRMAN. That will be all right.

(The figures requested by Senator Harrison of Undersecretary Winston are here printed in the record in full, as follows:)

Estimates of receipts and expenditures are made in the latter part of October each year to cover the current fiscal year; that is, the year ending on the following June 30, seven months from the date of the estimate, and for the succeeding fiscal year; that is, the year ending on June 30, 19 months from the date of the estimate. In estimating for the current fiscal year the Treasury knows the appropriations made for that year at the preceding session of Congress, but Congress can still affect expenditures by supplemental appropriations. In the estimates for the succeeding fiscal year the Treasury is obliged to act before Congress meets and before it knows to what extent appropriations will be made.

In the tables attached there are given the estimates for the current and succeeding fiscal years and the actual figures. There is added to this a statement of special items of receipts and expenditures which have been the most material factor during the period influencing a change from the estimated receipts or expenditures. These three items, railroads, War Finance Corporation, and sales of war supplies, are now either substantially eliminated as a factor or can now be determined with fair accuracy, there being practically no war supplies left to be sold, the War Finance Corporation has nearly completed its liquidation, and no further money is to be advanced to railroads, the stronger lines have paid off their indebtedness to the Treasury, and we may expect that the securities we now hold will not be paid before maturity.

Below is given a more detailed statement of the changes between the estimates and the actual receipts.

The principal reasons for the differences between the figures of estimated surplus or deficit for specified fiscal years and the actual results when all of the figures have been completed for such fiscal years, may be stated as follows:

(1) Changes made in revenue laws after the estimates have been submitted.

(2) Special items of receipts that could not have been anticipated.

(3) Specified classes of receipts due to liquidations of war assets with respect to which it is impossible to estimate accurately in advance.

(4) Changes in business conditions after the estimates have been submitted, which substantially affect the revenue, particularly income-tax receipts.

(5) Changes in disbursements due to increased or decreased appropriations therefor after the estimates have been submitted.

The estimates of internal-revenue receipts for the fiscal year 1922, as submitted in the annual report for the fiscal year 1920, were based on the revenue laws in effect at the time the annual report was submitted. In the annual report for 1921 the estimates of internal-revenue receipts for the fiscal year 1922 were based on

changes in the revenue act of 1921 and the aggregate internal-revenue receipts in such estimates are within practically $1,000,000 of the final figures for the fiscal year 1922 as published in the daily Treasury statements. The estimated internal-revenue receipts for the fiscal year 1923 as submitted in the annual report for the fiscal year 1921 differ from the actual figures by approximately $13,000,000. In the annual report for the fiscal year 1922, however, the estimated internal-revenue receipts for 1923 were substantially reduced on account of the severe business depression beginning in the calendar year 1921 and continuing for the first seven months of the calendar year 1922, which, if it had continued during the remainder of that calendar year, would undoubtedly have so reduced corporate profits as to bring the income-tax receipts substantially below the figures of the actual receipts for the fiscal year 1923. Like conditions apply to the estimated income tax for the fiscal year 1924, which appeared in the same annual report, namely, for the fiscal year 1922. In each of these cases, the estimates were necessarily based on a continuance of conditions prevailing at the time the estimates were prepared. For the fiscal year 1924, the estimates of internal-revenue receipts as they appeared in the annual report for 1923 were substantially increased on the basis of the marked improvement in business conditions in the last five months of the calendar year 1922, and continuing with added momentum during the greater part of the calendar year 1923. In this connection, the following is quoted as a part of the article under the caption "The domestic credit situation," appearing on page 40 of the Secretary's annual report for 1923:

"The low point in the demand for bank credit was reached about the middle of 1922, and since that time there has been a fairly steady upward movement in the volume of credit except for a slight decline during the summer months of the current year. The turning point in the demand for credit followed a gradual improvement in business activity which had begun almost a year previous. This growth in business activity gathered greatly increased momentum during the latter half of 1922 and the early months of 1923, and many new high records in production and trade have been made. Beginning with the spring and summer months, however, there was a slackening in many lines of activity and the autumn trade expansion has not been present on a scale commensurate with many previous active years. Business activity, however, is still much greater than a year ago and generally presents the appearance of being in a sound and stable condition."

The estimates of internal-revenue receipts for the fiscal year 1924 as they appeared in the annual report for the fiscal year 1923 were substantially above those in the annual report for the fiscal year 1922 based on the improved business conditions as reflected in the actual figures of income-tax receipts for the fiscal year 1923. The internal-revenue estimates so submitted do not vary materially from the actual results for the fiscal year 1924. The estimates of internal-revenue receipts for the fiscal year 1925 appearing in the annual report for the fiscal year 1923 were based on existing revenue legislation and necessarily do not take into consideration the tax reductions made in the revenue act of 1924. In the annual report for the fiscal year 1924 the estimate of income-tax receipts was approximately $100,000,000 less than the actual figures. That condition is thought to be due to failure to accurately estimate the tax reductions carried in the revenue act of 1924 as offset by increased collections due to lowering of the taxes. On page 17 of the Treasury's annual report for the fiscal year 1924, the following is a part of the article under the caption "Receipts and expenditures":

"Without the 25 per cent reduction in personal income taxes paid during 1924, total receipts from customs and internal revenue would have been about $100,000,000 in excess of estimates, a difference of only 3 per cent. The amount appears large only when viewed alone and disassociated from the tremendous totals of Government receipts. Ninety-seven per cent accuracy in pre-war estimates would have been considered exceptional and the total discrepancy would have been less than $24,000,000."

The above considerations with respect to discrepancies between estimated internal-revenue receipts and the actual figures also apply to the estimates of and actual figures of customs receipts. The estimate of customs receipts for the fiscal year 1923 appearing in the annual report for the fiscal year 1921 was made on the basis of the old law. In the report for 1922 the estimate was given as $450,000,000, while the actual returns showed receipts of approximately $562,000,000. The unknown factor of the new law and the abnormal world trade conditions then existing, made it appear that the estimate of $450,000,000 for the fiscal year 1923 was certainly as much as might reasonably have been expected. It was then

generally believed that the conditions responsible for the unusually high customs receipts under the new law would not continue. However, beginning with the estimates in the annual report for the fiscal year 1923, the customs receipts have not varied substantially from the actual figures for the years for which estimated, to and including the fiscal year 1925. The figures for expenditures in the estimates for the fiscal years 1922 and 1923 differed substantially from the actual expenditures, owing to the impossibility of accurately determining the effect of administrative pressure for economy and the uncontrollable expenditures during such years due to liquidations of obligations arising out of or incident to the war. Again, in some cases, the estimated expenditures were based on appropriations actually available without taking into consideration the amounts of probable expenditures due to supplemental and deficiency estimates. This has largely been corrected in the estimates for the more recent fiscal years.

There are given below statements showing the estimates and actual figures for each fiscal year from 1922 to 1925, together with figures showing the estimates and actual collections on account of special items of receipts and expenditures for such fiscal years. Similar statements are also given for the fiscal years 1919 to 1921.

Estimates of receipts and expenditures and actual receipts and expenditures for each fiscal year from 1922 to 1925, inclusive, appearing in annual reports of the Secretary of the Treasury for the fiscal years 1920 to 1924

[Figures given below are in even thousands]

	Fiscal year 1922			Fiscal year 1923			Fiscal year 1924			Fiscal year 1925		
	Estimates in annual report of—		Actual, 1922	Estimates in annual report of—		Actual, 1923	Estimates in annual report of—		Actual, 1924	Estimates in annual report of—		Actual, 1925
	1920	1921		1921	1922		1922	1923		1923	1[illegible]	
Customs	$350,000	$275,000	$356,443	$330,000	$450,000	$561,929	$425,000	$570,000	$545,638	$493,000	$550,000	$547,561
Internal revenue:												
Income tax	2,626,000	2,110,000	2,068,128	1,715,000	1,500,000	1,678,607	1,500,000	1,850,000	1,842,144	1,800,000	1,660,000	1,7[illegible]0,538
Miscellaneous internal revenue	1,375,000	1,104,500	1,145,125	896,000	900,000	945,865	925,000	933,585	953,012	927,585	826,325	828,638
Miscellaneous receipts	509,530	478,953	539,408	404,182	579,863	655,525	511,812	541,092	671,250	473,177	565,643	643,411
Total	4,859,530	3,968,453	4,109,104	3,345,182	3,429,863	3,841,926	3,361,812	3,894,677	4,012,044	3,693,762	3,601,968	3,780,148
Ordinary expenditures	3,897,419	3,604,960	3,372,608	3,268,415	3,373,713	3,129,418	2,835,746	3,053,070	3,048,678	2,815,802	3,062,277	3,063,105
Public debt retirements chargeable against ordinary receipts	325,855	387,942	422,[illegible]	369,339	330,089	402,861	345,097	511,968	457,999	482,278	471,807	466,538
Total	4,223,274	3,992,922	3,795,302	3,637,754	3,703,802	3,532,269	3,180,843	3,565,038	3,506,677	3,298,080	3,534,084	3,529,643
Surplus	636,256		313,802			309,657	180,989	329,6[illegible]	505,867	395,682	67,[illegible]	250,[illegible]
Deficit		24,469		292,572	273,989							

Estimates and actual receipts from specified sources in fiscal years 1922 to 1925

[In millions of dollars]

	Fiscal year 1922			Fiscal year 1923			Fiscal year 1924			Fiscal year 1925		
	In annual report of—		Actual, 1922	In annual report of—		Actual, 1923	In annual report of—		Actual, 1924	In annual report of—		Actual, 1925
	1920	1921		1921	1922		1922	1923		1923	1924	
Railroads	----------	[1] 338	139	----------	[1] 211	[1] 15	[1] 40	[1] 59	59	29	88	137
War Finance Corporation	----------	----------	[1] 94	----------	125	109	60	60	53	----------	30	43
Sales of war supplies	185	141	90	101	82	83	27	31	45	16	18	17
Net receipts	185	----------	135	101	----------	177	47	32	157	45	136	197
Net expenditures	----------	197	----------	----------	4	----------	----------	----------	----------	----------	----------	----------

[1] Excess of expenditures—deduct.

Estimates of receipts and expenditures and actual receipts and expenditures for each fiscal year from 1919 to 1921, inclusive, appearing in annual reports of the Secretary of the Treasury for the fiscal years 1917 to 1920

[Figures given below are in even thousands]

	Fiscal year 1919			Fiscal year 1920			Fiscal year 1921		
	In annual reports of—		Actual, 1919	In annual reports of—		Actual, 1920	In annual reports of—		Actual, 1921
	1917	1918		1918	1919		1919	1920	
Customs	$230,000	$190,000	$184,458	$220,000	$275,000	$322,903	$325,000	$350,000	$308,565
Internal revenue:									
Income and profits tax	2,427,000	5,000,000	3,018,784	3,000,000	3,750,000	3,944,949	3,000,000	3,220,000	3,206,046
Miscellaneous internal revenue	998,000	1,100,000	1,296,501	1,000,000	1,240,000	1,460,082	1,190,000	1,500,000	1,390,381
Miscellaneous receipts	442,715	563,900	652,514	722,000	842,450	966,631	905,000	669,565	719,941
	4,097,715	6,853,900	5,152,257	4,942,000	6,107,450	6,694,565	5,420,000	5,739,565	5,624,933
Ordinary expenditures	12,724,839	25,177,504	18,514,880	6,280,452	6,812,523	6,403,344	3,535,998	4,851,299	5,115,928
Public debt retirements chargeable against ordinary receipts			8,015			78,746			422,281
Total	12,724,839	25,177,504	18,522,895	6,280,452	6,812,523	6,482,090	3,535,998	4,851,299	5,538,209
Surplus						212,475	1,884,002	888,266	86,724
Deficit	8,627,124	18,323,604	13,370,638	1,338,452	705,073				

Special items of receipts and expenditures, fiscal years 1919 to 1921

	Fiscal year 1919			Fiscal year 1920			Fiscal year 1921		
	In annual reports of—		Actual, 1919	In annual reports of—		Actual, 1920	In annual reports of—		Actual, 1921
	1917	1918		1918	1919		1919	1920	
Railroads		[1] $350,000	[1] $358,795		[1] $751,000	[1] $1,036,672		[1] $1,078,000	[1] $730,711
War Finance Corporation		[1] 445,000	[1] 302,622		[1] 150,000	228,472			22,028
Sale of war supplies			17,712		628,000	314,314	$263,000	299,000	184,720
Net expenditures		795,000	643,705		273, 00	493,886		779,000	523,963
Net receipts							263,000		

[1] Excess of expenditures—deduct.

Undersecretary WINSTON. Shall I answer the question that was asked yesterday, Mr. Chairman?

The CHAIRMAN. Yes.

Undersecretary WINSTON. Senator Jones yesterday spoke about the difference between a taxable and a nontaxable bond. In the case of the first Liberty loan bonds the 3½ per cent are fully tax exempt, and the 4¼'s pay a normal tax only.

From 1920, which is as far as I have gone back, until December 15, 1923, the first 3½'s sold at a higher price on the market than the first 4¼'s, although it is the same bond, the same maturity date. Since then the 3½'s have gone off compared to the 4¼'s, so that now the 4¼'s are about two points above the 3½. Taking the difference in the yields, which is the best test of the value of this tax exemption to the investor, and I have gone back just the three years that I spoke of to Senator Jones, and for six-month periods, in 1923 the difference in yield between the two securities was 0.92 of 1 per cent. That has gone consistently down until on December 15, 1925, it was 0.40 of 1 per cent.

The CHAIRMAN. And yesterday it was 0.37 of 1 per cent.

Undersecretary WINSTON. Yes.

Senator SHORTRIDGE. In favor of which bond?

Undersecretary WINSTON. The change is in favor of the taxable bond as against the tax-exempt bond. I will put this table in the record, if it is satisfactory, showing this yield.

Secretary MELLON. In other words, the expectancy of reduced surtaxes is having its effect on the price of tax-exempt securities.

Senator REED of Pennsylvania. Well, now, Mr. Winston, if you carried that back to 1920 it would make the point all the plainer, would it not?

Undersecretary WINSTON. Except that I had to get this up this morning, Senator Reed, and we did not have the yield returns back of three years, I mean we did not have the record, and we would have to calculate them out, and we did not have time.

Senator REED of Pennsylvania. I should think you could get that in a few minutes by taking the files of the newspapers.

The CHAIRMAN. The files of the New York Times would give it.

Undersecretary WINSTON. Well, I can take this statement back and not put it in now, and go back to that date and put those figures in instead.

Senator REED of Pennsylvania. Could that not be done?

The CHAIRMAN. Yes; and in place of the one you just now asked to be inserted in the record we will insert the complete report in its place.

(The tabulation presented by Mr. Winston for the record is here printed in full, as follows:)

Prices and yields on first Liberty loan 3½ per cent bonds and first Liberty loan converted 4¼ per cent bonds, June 15, 1920, to December 15, 1925

[Yields calculated to callable date, June 15, 1932]

	First 3½'s		First 4¼'s		Differences in yields
	Prices	Yield	Prices	Yield	
		Per cent		*Per cent*	*Per cent*
June 15, 1920	$91.86-$92.00	4.371	$85.40-$86.00	5.933	1.562
Dec. 15, 1920	90.04- 90.10	4.623	86.00- 86.06	5.944	1.321
June 15, 1921	88.46- 88.60	4.85[illegible]	87.74- 87.80	5.767	.909
Dec. 15, 1921	95.20- 95.36	4.0[illegible]7	97.22- 97.40	4.575	.518
June 15, 1922	100.10-100.16	3.485	99.96-100.00	4.251	.766
Dec. 15, 1922	100.48-100.54	3.437	98.76- 98.88	4.403	.966
June 15, 1923	100[illegible] -101.00	3.372	98[illegible] - 98[illegible]	4.491	1.119
Dec. 15, 1923	99[illegible] - 99[illegible]	3.517	98[illegible] - 98[illegible]	4.482	.965
June 15, 1924	101[illegible] -101[illegible]	3.306	102[illegible] -102[illegible]	3.931	.626
Dec. 15, 1924	100[illegible] -101.00	3.353	101[illegible] -101[illegible]	3.992	.639
June 15, 1925	101[illegible] -101[illegible]	3.311	102[illegible] -102[illegible]	3.812	.501
Dec. 15, 1925	99[illegible] - 99[illegible]	3.535	101[illegible] -101[illegible]	3.926	.391

The CHAIRMAN. Mr. Secretary, is there any further statement that you wanted to make?

Secretary MELLON. I do not recall anything that was requested yesterday.

The CHAIRMAN. Well, you have not made any statement yet as to the surtaxes or normal tax.

Senator MCLEAN. Or the inheritance tax.

The CHAIRMAN. Or the inheritance tax, or the gift tax.

Senator JONES of New Mexico. Did he not make that statement before the House committee?

The CHAIRMAN. I do not know.

Senator SHORTRIDGE. May I ask the Secretary a question or two, Mr. Chairman?

The CHAIRMAN. Certainly.

Senator SHORTRIDGE. You appeared before the House committee when this bill was under consideration?

Secretary MELLON. Yes.

Senator SHORTRIDGE. I see on pages 6 and 7 of the hearing as printed, before the Committee on Ways and Means of the House, that you took up and discussed the subject of estate taxes.

Secretary MELLON. Yes.

Senator SHORTRIDGE. And may I assume that you gave your deliberate and mature judgment as to the subject matter mentioned? You gave your mature, deliberate judgment as to the subject matter you discussed?

Secretary MELLON. Yes. It was the opinion of the Treasury that the estate and inheritance taxes were particularly matters subject to State taxation rather than of Federal taxation. And that the Federal Government could relinquish the estate taxes. That we could do without the revenue which is obtained from the estate taxes.

Senator SHORTRIDGE. Well, not to multiply questions or to take up your time——

Senator SIMMONS. Pardon me, may I ask one question, Senator?

Senator SHORTRIDGE. Yes.

Senator SIMMONS. What were the receipts from inheritance taxes last year?

Undersecretary WINSTON. A little over $101,000,000.

Secretary MELLON. $104,000,000.

Senator SIMMONS. So you thought you could do without them?

Undersecretary WINSTON. An explanation is required for that, Senator Simmons, in that there is no loss in the estate taxes in the first year if you repeal them, and the loss would come in the second, third, and fourth years, and revenue gradually diminish.

Secretary MELLON. The estate taxes are not payable until a year after death, and then they are subject to further postponement, so that the actual collection of estate taxes comes one, two, three, and four years after.

Senator SIMMONS. I can understand that, but that does not interfere at all with the amount that you get annually, I do not think, because in the case of some deaths that occurred two years ago the taxes are becoming payable now. That is just a continuing process. It does not seem to me that that changes the situation now.

Secretary MELLON. Well, of course, when that recommendation was made for the elimination of the estate taxes, all of the other reductions were not contemplated. For instance, we did not recommend a reduction of the automobile tax. But it fitted into the plan or the estimates of the Treasury, the plan of tax reduction.

Senator SIMMONS. You mean by that, Mr. Secretary, to say that the amount of tax that the House bill retained on inheritance about equaled the amount of tax you would lose by the reduction of automobile tax; is that what you mean to say?

Secretary MELLON. And some of the other taxes.

Senator SHORTRIDGE. There are one or two more questions. Have you read the report as it is here set down of the views that you have expressed, and may we assume that this is correctly set forth?

Secretary MELLON. Yes.

Senator SHORTRIDGE. Well, not to take too much time, I understand your position to be in theory against Federal inheritance taxes.

Secretary MELLON. Yes.

Senator SHORTRIDGE. What change or suggested difference in view do you now have from what you then expressed, as found here set out in the report?

Secretary MELLON. No change of views; no change regarding the general policy. But since the bill as it has been framed by the House committee does not take into consideration the repeal of that law, then comes in the question of revenue.

Senator SHORTRIDGE. Are you able to tell the committee now what loss of revenue there would be if the provisions in the bill were made retroactive?

Secretary MELLON. I do not know what that would amount to.

Senator SHORTRIDGE. Has there been an estimate made of that, do you know, Mr. Winston?

Senator KING. What do you mean by that, Senator?

Senator SHORTRIDGE. Assuming that this is changed as contemplated in the present bill before us, carrying it back to June 7, 1924.

Senator KING. Oh, you mean cut off any taxes, and exempting those estates which are now in process of settlement, and which under

the existing law would pay this year and next year—exempt them entirely?

The CHAIRMAN. I will say to the committee, that when that question comes up I have numerous letters upon it, and I can always tell when the party died by the dates named in the letter as to when they want the retroactive feature to go. Some want it to go to the 7th of February, and some to the 1st of February, and some as far as the 27th of March. But upon an examination of it I notice in the paper that some wealthy man had died just the day following, or a week following that date.

Senator KING. Well, I beg to suggest to Senator Shortridge that if you make this retroactive at all so as to exempt the estates which are in process of settlement of taxes you will in justice have to refund to the estates that you have already collected taxes on, that is to the estates that have been diligent in payment of the taxes, so it will mean millions and millions of dollars that we will now lose, and we will have to take money from the Treasury to refund to the estates that have been diligent in payment of the taxes.

Senator SHORTRIDGE. There would have to be an estimate of the amount involved before that would be discussed.

Secretary MELLON. You did not apply that rule in the other tax reductions.

The CHAIRMAN. On miscellaneous taxes you did not.

Senator KING. Well, may I say to you, Mr. Secretary, that the presumption is that you do not allow the people three or four years to pay the taxes, but you collect them when they are due.

Secretary MELLON. Yes.

Senator SHORTRIDGE. If this bill is passed in its present form as to Federal estate taxes, is it or is it not a fact that citizens, taxpayers, will be thrown into three different classes, so to speak, and pay different rates?

Secretary MELLON. Yes.

The CHAIRMAN. That has happened every time we have made any change in the law.

Senator SHORTRIDGE. Well, it has happened and may happen in this case when applied to this class or type of taxes.

The CHAIRMAN. It could not be otherwise. As long as the estates back of the present law are unsettled there are bound to be two classes at least.

Secretary MELLON. I think it was desirable to have the Federal estate taxes abolished, but the House bill retained the tax, and it is necessary now to have the revenue, and it seems to me that it is so important that this bill should be enacted in time to apply to this year's income that it would hardly be practicable to make any change now in that respect.

Senator JONES of New Mexico. Mr. Secretary, if I remember correctly, the present House bill provides that the amount of the State taxes upon estates up to 80 per cent of the Federal taxes shall be remitted to the State?

Secretary MELLON. Yes.

Undersecretary WINSTON. That is not quite accurately stated, Senator.

The CHAIRMAN. No; you did not state it all.

Senator JONES of New Mexico. Provided that the State levies a tax of the amount.

Senator KING. Suppose there are two or three States levying taxes, Senator?

Senator JONES of New Mexico. Well, as I understand it the same rule applies. That part in one State would be dependent upon the law of that State, and the other part in the other State upon the law of that State.

Senator KING. Yes.

Senator JONES of New Mexico. How much revenue is lost to the Federal Government by reason of that provision?

Secretary MELLON. I do not think it would be possible to estimate that. The States have varying rates of charge. And I know that in some of the States they are expecting to increase their inheritance tax in order to be able to get the benefit of this 80 per cent return.

Senator JONES of New Mexico. If we do not know that how can we estimate what the returns from that provision of the law will be?

Secretary MELLON. It would be difficult, but it will not affect the present year to a very large extent. It will not affect it at all for the current year.

Senator JONES of New Mexico. Well, do you approve of that idea of remitting to the estates the amount of the State taxes upon those estates up to 80 per cent of the Federal revenue?

Undersecretary WINSTON. It ought to be stated the other way, Senator, that the estate, that is, the taxpayer, gets a credit on his Federal tax to the extent of 80 per cent of that tax, as far as he has to pay taxes to various States.

Senator JONES of New Mexico. Well, I stand corrected. That really was what I had in mind. You credit the estate with it instead of paying it over to the State?

Undersecretary WINSTON. Yes.

Senator JONES of New Mexico. So that it comes back to the same general principle.

Secretary MELLON. Well, now, answering your question, I do not think that is desirable. I do not think it is a sound arrangement. It is complicated, and it is something that is scarcely the appropriate sphere of the Federal Government to influence and direct the method of taxation in the States. And I know the question has been raised in one or two of the States where they say they will have to call a meeting of their legislature in order to pass a law to suit this 80 per cent refund.

Senator JONES of New Mexico. Well, what do you think of the constitutionality of that provision in regard to the equalization of taxes, or that the Federal taxes should be equal?

Secretary MELLON. Well, Mr. Winston is a lawyer; I am not.

The CHAIRMAN. I had our attorneys make a thorough investigation into it, Senator Jones, and one member of the Ways and Means Committee asked me to send their opinion over. I did so, and they have not returned it to me.

Senator WATSON. Whose opinion was it?

The CHAIRMAN. Mr. Lee, together with his associates, spent considerable time over it three months ago.

Senator WATSON. What was their conclusion?

The CHAIRMAN. Their conclusion was that it was constitutional.

Senator GERRY. Does it complicate the situation, Mr. Secretary, that the Federal tax is an estate tax, while in most States it is an inheritance tax? Sometimes an estate and sometimes an inheritance tax, while the Federal tax is an estate tax and nothing else?

Secretary MELLON. That does not complicate it so far as the Federal Government is concerned, so far as the Federal tax is concerned. Of course, the State will have to adjust its tax to suit.

Senator GERRY. That is what I mean; it does not complicate the bookkeeping of the Federal Government?

Secretary MELLON. No.

Senator GERRY. But it would complicate the State action?

Secretary MELLON. Yes.

The CHAIRMAN. More than likely half of the States will have to have legislation.

Senator REED of Pennsylvania. Mr. Secretary, what do you think of the fairness of this system of taxation, of estate taxation as compared with inheritance taxation? I worked out the other day the tax on two bequests each of $100,000. If I were to receive all of an estate of $100,000 the Federal estate tax on it would be $500. If my brother were to receive exactly the same legacy from a $5,000,000 estate, his tax would be over $19,000. Does that appear to you to be just?

Secretary MELLON. It does not seem so.

Senator REED of Pennsylvania. Has the Treasury ever made any study of an inheritance tax which could be substituted for this estate tax?

Secretary MELLON. I do not know of any study having been made of that.

Senator KING. Senator Reed, as I understand you, then, the tax varies, dependent upon the value of the estate?

Senator REED of Pennsylvania. Yes.

Senator KING. Or the distributive share.

Senator REED of Pennsylvania. I do not mean to go into a lengthy discussion, but in an inheritance tax the amount of tax is based on what the live man gets, but in this present system of tax it is based on what the dead man leaves.

Senator SIMMONS. My impression is, Senator Reed, that this committee did at one time report on that.

Senator REED of Pennsylvania. Senator Gerry and I made the request a year ago.

Senator JONES of New Mexico. During the preparation of the last two bills the Senate committee has put itself on record as favoring succession tax or inheritance tax rather than an estate tax.

Senator WATSON. I know that was the action of our committee this last year.

The CHAIRMAN. In 1921 we struck out the House provision and substituted an entirely new provision.

Senator JONES of New Mexico. And we did the same thing in the preparation of the last bill.

The CHAIRMAN. We did not put it in.

Senator JONES of New Mexico. Yes; we put it in, but we receded in conference.

Senator REED of Pennsylvania. I remember we had the amendment printed. I don't know whether it was adopted.

Senator JONES of New Mexico. The Senate adopted it.

Senator SIMMONS. Well, Mr. Mellon, there is a provision in the present law allowing 25 per cent.

Undersecretary WINSTON. This 80 per cent credit is just an extension of that.

Secretary MELLON. This is just an extension of that same thing.

Senator SIMMONS. That is what I wanted to ask you about. You stated it was a very complicated method. Have you experienced any trouble in settling under the present law the estates?

Secretary MELLON. The complication arises in the application in the States. Not to us in the Federal Government.

Senator SIMMONS. I understand that, but I was asking you therefore, if you had had much trouble in administering the present law allowing 25 per cent reduction?

Secretary MELLON. The trouble in administering the law does not affect our administration of it. It is the administration or the collection in the States. They have to adjust theirs.

Senator SIMMONS. Well, the trouble would be the same after this provision in the House bill is passed as you are having now?

Secretary MELLON. Yes.

Senator SIMMONS. You have the same trouble now?

Secretary MELLON. Yes.

Undersecretary WINSTON. The difficulty is, Senator Simmons, that the States want to come up to the full 25 per cent credit.

Senator SIMMONS. I understand.

Undersecretary WINSTON. And they have an inheritance tax instead of an estate tax, and it is a very complicated matter to fix their rates so that they will come up to that particular credit.

Senator SIMMONS. But it is no greater difficulty than you have now.

Senator HARRISON. Does this law take care of that at all? Give them any time to re-form their law?

Secretary MELLON. No.

Senator HARRISON. Well, why should it not? Some legislatures do not meet for two years, say.

Secretary MELLON. May I read the statement which I read before the Ways and Means Committee of the House on this subject? It is short [reading]:

There is no logical basis for the Federal Government collecting this tax. The right of inheritance is controlled by the States and the Federal estate tax is based only upon the theory that to transmit property by death is the exercise of a privilege which can be made subject to taxation, just as we might levy a tax on the privilege of selling property. The present law, with its 40 per cent maximum, has not been before the Supreme Court, and the question has never been determined as to whether or not you can confiscate a large part of the property through a tax on the exercise of the privilege of transferring it. Would a sales tax be constitutional which took the bulk of the property sought to be sold? The States are confronted with no such question. They alone control inheritance. I raise this point simply to show that the tax is one belonging to the States and not to the Federal Government.

Estate taxes have always been a source of emergency revenue. It is only in war periods that the Federal Government has made use of them, and except in the present case they have always been repealed when the emergency ended. They should be saved for this purpose. We ought not to use our reserves in time of peace. We may need them badly when the next emergency arises. There is no emergency now.

Senator SIMMONS. Well, Mr. Secretary, did we not have an estate tax before the war?

Secretary MELLON. There was an estate tax during the——

Senator REED of Pennsylvania (interposing). During the Spanish War.

Senator WATSON. There was an estate tax during the Spanish War, and repealed right afterwards.

Secretary MELLON (continuing reading):

Taxation by the Federal Government is going down and that of the States going up. The States need every source of revenue available. In the majority of States the Federal tax directly decreases the property which the State can tax. For example, if an estate pays $1,000,000 of tax, this is deducted from the net value of the property on which the State percentage is levied. The States get no tax on the value represented by what the Federal Government has taken. Aside from the direct loss of revenue to the States, there is an indirect loss. The present muddle of death taxes in this country could in some cases take more than 100 per cent of what a man leaves. Excessive Federal taxes contribute largely to this muddle. The result must be that ultimately values are destroyed and with them the source from which the States must take revenue.

Under considerably lower rates the Federal estate tax once yielded about $150,000,000 a year revenue. This has gradually dropped off to $100,000,000, last year's revenue from this source being slightly below that of the year before. It is quite within the revenue requirements of the Government to eliminate this tax. If not in one year, certainly the rates might be materially cut in 1926 and the whole tax repealed in 1927. The revenue collections from this tax will exist for some time after the law is repealed. Taxes are not payable until a year after the death of the decedent. There are extensions of payment beyond that date without interest and further extensions with interest. The result is that a repeal of the act effective January 1, 1926, would not be reflected at all in revenue collections until after January 1, 1927, and then revenue from the tax would gradually diminish for the next four or five years. So an immediate repeal would not affect the revenue of the fiscal year 1926 and but half of that of 1927.

The CHAIRMAN. Well, we all have to admit that an estate tax is a tax on property. It is not a tax on gains at all.

Senator KING. Mr. Secretary, how much is still due in taxes from estates? I understood Mr. Winston to state that there are some that are two or three years back yet in payments, and I was wondering what the aggregate was which you would realize within a reasonable time? If there would probably be a large proportion of it during the coming year?

Undersecretary WINSTON. I did not state that the taxes were due. Estate taxes do not become due and payable until a year after a man's death, so that the tax on the estate of a man that died on January the 1st, 1926, would not be due and payable until January 1, 1927.

Senator KING. I did not state the proposition accurately. How much do you expect to realize from estates where the decedent is now dead, if you will allow the Irish bull.

Senator SIMMONS. Well, I do not see that that question of coming due in a year or two has anything to do with it.

Senator KING. I do not agree with you. It has this to do with it, if there are $10,000,000, $20,000,000, $40,000,000, or $50,000,000 that we can count upon assuredly of swelling the revenues during the coming year.

Senator SIMMONS. You and I agree entirely. We do not disagree. What I said was that they can calculate upon the same amount of revenue from this tax year after year notwithstanding that a part of it is not due in the year.

Senator KING. I beg your pardon. What I was asking was, how much we can figure on getting in the next year?

The CHAIRMAN. $110,000,000.

Senator KING. Assuming that we shall repeal the tax to-day, you would count on $100,000,000?

The CHAIRMAN. Yes.

Undersecretary WINSTON. We would get the same amount as if we did not repeal it.

Senator KING. Would not some estates be settled quickly?

Undersecretary WINSTON. They would be very foolish if they did, because they do not get any discount for doing it.

Senator SHORTRIDGE. After the one year the unpaid balance carries 6 per cent interest?

Undersecretary WINSTON. After 18 months I think it carries interest.

Senator SHORTRIDGE. Mr. Chairman, may I interrupt just once more, and then I shall not trouble you further. I have offered, or suggested that I intended to offer, an amendment to this bill, and the committee members will find the proposed amendment printed. It may be a little service to suggest that the scope of this amendment is to strike out the words "after the enactment of this act" found at the top of page 152, and insert in lieu thereof the words "after the enactment of said Title III of the revenue act of 1924." Making no change whatever in the rates contemplated here for the future.

Senator HARRISON. You have a very deserving case that you want to take care of?

Senator SHORTRIDGE. There are a great many deserving cases that ought to be taken care of, even in Mississippi.

Senator HARRISON. I agree with you there thoroughly. One case you have got is very deserving.

Senator SHORTRIDGE. Well, personally, I have not one case or ten cases or a hundred. I am opposed to the whole plan of estate taxes, and I want them reduced.

Senator WADSWORTH. Mr. Secretary, a suggestion was made to me the other day with respect to the estate taxes assessed under existing law, and the suggestion arose in connection with this discussion that this bill should be made retroactive in the reductions made. Of course that is the discussion you have heard about. It has been touched on here by Senator Shortridge.

Senator SHORTRIDGE. The committee first voted that way.

Senator WADSWORTH. These gentlemen talking with me, of course, were very much in favor of the retroactive suggestion. But assuming that they could not get it, or that the Congress would not give them that relief, they suggested the elimination of the interest charge on their installment payments.

The CHAIRMAN. You mean after the 18 months?

Senator WADSWORTH. After the 18 months; yes.

The CHAIRMAN. You see they do not pay any interest for 18 months.

Senator WADSWORTH. I know. But these payments on the installment plan run for four or five years. And they will pay tremendous sums in interest to the Government in addition to the taxes.

The CHAIRMAN. But we would save that amount of interest if they did pay it in advance. I do not think they can.

Senator WADSWORTH. But they can not.

The CHAIRMAN. But then we pay interest ourselves on the obligation.

Senator WADSWORTH. But not at 6 per cent by any means.
The CHAIRMAN. No.
Senator WADSWORTH. I think it can not be denied that the Government has those people by the throat in that respect and squeezes them.
Senator WATSON. For five years.
Senator WADSWORTH. Yes, sir.
The CHAIRMAN. Of course, I am opposed to the whole thing.
Senator WADSWORTH. The Government charges them 6 per cent on their installments until the final one is paid, and you run that over three or four or five years and you run up about 18 and 24 per cent interest before they get through, and they are helpless in it, and you are charging them more than the Federal Government pays for its money.
Undersecretary WINSTON. Six per cent interest, I think, is used throughout the act, both on refunds and additional taxes; both the same figures.
Senator REED of Pennsylvania. If you will lower the interest you will find that no estate will pay within six years; they will all take advantage of it.
The CHAIRMAN. They will all take advantage of it.
Senator WADSWORTH. Well, very few can pay before the interest begins to run.
The CHAIRMAN. Well, but if the interest did not run they would not pay until the end of the term.
Senator WADSWORTH. Yes; but is not the Government getting the full face of the tax anyway?
The CHAIRMAN. Well, not the value of the tax as it falls due under the law.
Senator WADSWORTH. Well, we make all our estimates here on the actual receipts of the taxes assessed. I am not making the suggestion. This is a suggestion made to me, and I am not entirely clear on it, but I do see that a large estate which can not pay a very heavy estate tax within the 18 months period is thereupon caught. It must pay eventually; it pays on the installment plan. It has no choice in the matter. Its executors simply can not raise the money. And while they are making that struggle to pay the Government asks them 6 per cent interest.
Secretary MELLON. There may be an injustice there, but I rather think the relief would have very narrow application. I have never heard any complaint on that score. I mean, there have not been any cases brought to us which showed any injustice or harsh bearing of it.
Senator WADSWORTH. Of course a suggestion like this had not been brought up before the action of the House committee in reversing its plan on this question of the retroactive feature of the estate tax. That is what has brought it all up. It never was thought of otherwise.
The CHAIRMAN. Well, it was the second proposition that they wanted changed in the law. If they can not get the retroactive feature of it then they want the interest feature of it. I guess I have got 20 or 30 letters here on the same subject, and when we reach that I intend to bring it to the attention of the committee.
Senator HARRISON. The House committee changed its position.
Senator WADSWORTH. The House committee had it retroactive, and then changed it.

Senator SHORTRIDGE. Mr. Winston, may I ask you a question? Is it not a fact, or is it a fact—I do not know—that some word went up to the Treasury Department that if the tax was made retroactive, as the committee had voted, it would result in a loss of some $70,000,000 to the Treasury?

Undersecretary WINSTON. I think maybe Mr. McCoy figured that. Those matters were all taken up in the committee, and after Mr. Mellon appeared before the Ways and Means Committee the Treasury had nothing further to do with the bill. I mean we did not make any of these suggestions of the 80 per cent credit or the retroactive feature.

Senator SHORTRIDGE. Well, some one has told me, or I have read, to the effect that it was because of that information that the House committee reversed its position. I am further told, or have read, that those figures were quite erroneous; there would not be a loss of revenue exceeding $25,000,000, possibly $30,000,000.

Senator WATSON. Well, Mr. McCoy is here and can tell us what his estimates were.

Undersecretary WINSTON. I never made the estimates. Mr. McCoy may know about them.

Senator SHORTRIDGE. Well, that information went to the committee, did it not?

Undersecretary WINSTON. I do not know. It did not come from any people in the Treasury unless it was Mr. McCoy.

Secretary MELLON. I do not recall any information on this subject, and as Mr. Winston said, after making our first presentation before the committee we did not appear. They worked out all of those questions.

Senator SHORTRIDGE. I did not know but what you perhaps had sent some communication to that effect.

Undersecretary WINSTON. They consulted us neither in putting the retroactive feature in nor taking it out.

Senator WATSON. What is your estimate of the loss, Mr. McCoy?

Mr. MCCOY. The estimate I gave the committee for the calendar year 1926 is $20,000,000 loss of revenue, or if you would make it retroactive for two years you would lose the difference between the new rate and the 1924 rate, which is 15 per cent. The 15 per cent would probably bring it up to fully $100,000,000 final loss spread over five years.

Senator REED of Pennsylvania. Mr. Secretary, there are one or two questions that I wanted to ask you about features in this bill. I see that the House bill reduces the tax on pure grain alcohol.

Secretary MELLON. Yes.

Senator REED of Pennsylvania. And that it is estimated that there will be a loss of revenue of about $10,000,000 on that account. A very large number of the reputable druggists, drug manufacturers of the country, like Parke, Davis & Co. and others, have asked that that tax be not reduced.

Secretary MELLON. Yes.

Senator REED of Pennsylvania. Saying that it amounts to very little on each prescription, and that the tax operates to exclude pure grain alcohol from use by bootleggers and manufacturers of illegal liquor. Their position is that if the tax were reduced more of that pure alcohol would be used in whisky manufacture, and as the result the Treasury regulations would have to be necessarily much more

severe, and that they will lose more in the end than the amount of the tax that they are paying. What is your view as to the advantage to be secured from the reduction of that tax?

Secretary MELLON. That reduction was not made on recommendation of the Treasury. In fact, it had been made by the committee before it came to my attention. Mr. Andrews, the Assistant Secretary in charge of the prohibition department, made a statement there in regard to its bearing on prohibition, on the work of the department. As far as we could gather from the evidence of the people who are qualified in the department to speak, the bearing of it on prohibition is problematical. It is not likely to have any material effect one way or the other on the business of the bootlegger. However, the chief objection to the reduction which was made by the Ways and Means Committee is upon the loss of revenue.

Senator REED of Pennsylvania. The tax is easy to collect, is it not?

Secretary MELLON. Yes.

Senator REED of Pennsylvania. It does not cost much to collect it?

Secretary MELLON. No.

Senator REED of Pennsylvania. It costs as much to collect a part of it as to collect the whole amount?

Secretary MELLON. Exactly.

Senator REED of Pennsylvania. And the people who pay the tax do not want it reduced. I do not think there was any occasion for the reduction.

Senator WATSON. I think the small druggists all over the country want it reduced.

The CHAIRMAN. I do not think it is the drug stores, Senator. I think it is the doctors, from the letters I have received.

Secretary MELLON. I might say that after we looked into it I took the matter up with Mr. Green, the chairman of the committee, to see whether we could have a rehearing on it, and he said it had gone too far; there could not be a reconsideration of the question unless they gave those people a chance to be heard again, which they could not do. And they could not rectify it.

Senator WATSON. My understanding is, from my reading of this bill, that this tax is not decreased until after one year and then there is a certain percentage of decrease.

The CHAIRMAN. One year after the passage, or until January 1, 1927.

Senator REED of Pennsylvania. It appears on page 257 of our bill.

The CHAIRMAN. Yes; page 257 of our bill here.

Senator REED of Pennsylvania. Under the new rates——

> Until January 1, 1927, $2.20 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon;
>
> On and after January 1, 1927, and until January 1, 1928, $1.65 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and
>
> On and after January 1, 1928, $1.10 on each proof or wine gallon,

and so forth. Evidently intended to allow for adjustment.

Senator HARRISON. Is this one of the old war taxes?

Secretary MELLON. No; it is the general excise tax.

Senator KING. Mr. Secretary, you may not care to express an opinion upon this subject, and I would not care to ask it if you do not care to do so. Aside from the question of revenue, what do you say of the advantages of this tax on alcohol for medicinal pur-

poses, and the effect it would have in obtaining medicines for the people, and the advantages or disadvantages which would result to the manufacturer or retailer, or the manufacturer of proprietary medicines, or to the doctor?

Secretary MELLON. I have not gone into the question, and have not made an investigation, and am not prepared to give an opinion.

Senator KING. Very well.

Senator REED of Pennsylvania. I have been told that the reduction would amount to approximately 2 cents on an average prescription. Do you know whether that is so, or not?

Secretary MELLON. I do not.

Senator WATSON. I think that is a high estimate.

The CHAIRMAN. Even at that, they could stand it.

Senator WADSWORTH. A prescription amounting to 60 or 70 cents in a drug store pays a tax on the alcohol content of about 1 cent.

The CHAIRMAN. Not more than that.

Senator WADSWORTH. It is inconceivable that it would be a hardship.

The CHAIRMAN. It is known what percentage they make on these prescriptions. And I have been in the drug business all my life, and I know.

Senator SIMMONS. Mr. McCoy says that only a small part of it is used in prescriptions.

The CHAIRMAN. That is true.

Senator SIMMONS. This is the most remarkable situation that I have known in all my experience in tax making, a protest against a reduction in the taxes. I think we ought to know who it is that is making this protest, and just what the demand is.

The CHAIRMAN. The only interest I have is to get the $90,000,000, and get it easily.

Senator SIMMONS. I understand what the idea is.

Senator REED of Pennsylvania. The people who came to me were very frank in disclosing their interest in the matter. And they were people like Parke, Davis & Co., a concern in Detroit, Eli Lilly & Co., of Indianapolis.

Senator WATSON. They are opposed to this reduction?

Senator REED of Pennsylvania. They are very much opposed to it, and their real reason, so far as I could get it, is that the prohibition enforcement in connection with it will be made so severe that it will embarrass them more than the amount of the tax. They say the tax acts as a silent policeman for them.

Senator SIMMONS. Then the protest comes from the manufacturers of the alcohol?

The CHAIRMAN. Yes.

Senator SIMMONS. When I got to my office this morning I found a large batch of telegrams and letters from concerns in my own State, and some without my State, and all of them insisting that the tax should not be disturbed.

Senator REED of Pennsylvania. I have had telegrams from the patent medicine manufacturers, like the manufacturers of the Doctor Munyon remedies, protesting against any change from what the House has done. They want the tax.

Senator SIMMONS. The House committee has had hearings on this matter, and I suppose they were induced to make this reduction because of an overwhelming demand in favor of it. Those who

were not in favor did not seem to make themselves heard before the House committee.

Senator WATSON. It came from the doctors and the small druggists; they are the ones that inspired it. I have got the letters and I know where it comes from in Indiana.

The CHAIRMAN. I do not think so, entirely.

Senator REED of Pennsylvania. At all events, we have the Secretary's opinion on the subject, and I do not think it is well to spend too much time on it.

The CHAIRMAN. No.

Senator KING. I would like to ask that Senator Wadsworth be given an opportunity to express his opinion on this matter. I am sure he has something to say.

Senator WADSWORTH. I have nothing, Senator.

Senator REED of Pennsylvania. I have one or two other questions I would like to ask the Secretary.

Secretary MELLON. Very well.

Senator REED of Pennsylvania. One of Senator Shortridge's constituents came to me and made the statement that early in 1924 his mother had made gifts of a large amount of property to her children—entirely as a gift. That was done in March, 1924, and the revenue act in June, 1924, put on a retroactive gift tax——

Secretary MELLON (interposing). Yes.

Senator REED of Pennsylvania. This lady could not have heard of it at the time she made the gifts, because the act was not then passed, and now a tax of $300,000 is claimed from her donees on the gifts, on account of a tax subsequently imposed.

Secretary MELLON. Yes.

Senator REED of Pennsylvania. Can you tell us what the result would be if we repealed the retroactivity of the gift tax? That is, make it effective as of June 1, 1924, instead of January 1, 1924?

Undersecretary WINSTON. We can give it to you in a few moments. I have got it here. In the gift tax of about $7,000,000 collected during the last calendar year, $4,440,000 were collected on gifts made prior to June 2, 1924; and $2,704,000 on gifts made after June 2, 1924—June 2 being the effective date of the law.

Senator REED of Pennsylvania. Has there ever been a decision of the courts on the constitutionality of a retroactive excise tax?

Undersecretary WINSTON. I do not know of any, but the question is now in litigation on these gift taxes.

Senator REED of Pennsylvania. Has the Treasury any recommendation on that retroactive gift tax?

Senator HARRISON. This case that this man presented appeared to be a pretty bad case.

Secretary MELLON. I think it is certainly inequitable to put a tax on a gift where the donor was totally ignorant or without any knowledge that there might be a tax put on; it does not seem right.

Senator REED of Pennsylvania. It seems to me it is a dishonest governmental act to do it.

Secretary MELLON. Yes.

The CHAIRMAN. Then you might as well say that any retroactive tax is dishonest.

Senator REED of Pennsylvania. Any retroactive excise tax is dishonest, because it implies a right to do, or not to do, a certain act.

Undersecretary WINSTON. I do not know that we have ever had such an act.

Senator REED of Pennsylvania. One other subject, Mr. Secretary.

Secretary MELLON. Yes.

Senator REED of Pennsylvania. The last time we had such a question here, the Finance Committee raised a corporation income tax abolishing the capital stock tax, and the reason stated at that time was that it seemed a waste of money by the Government to have two fiscal years; the capital stock tax had a fiscal year that was fixed, and the corporation income tax had a fiscal year that coincided with the caldendar year; and it seemed wasteful to us, in that it required two sets of reports made up on different bases and required the maintenance of separate units in your department.

Secretary MELLON. That question was considered by the Ways and Means Committee, and so far as the Treasury is concerned it was immaterial because either way the revenue amounted to the same. In favor of the present bill, that is, retaining the capital stock tax, it is a fact that the corporations have been subject to it and they are accustomed to it, and there is something to be said in favor of a tax when they have become accustomed to it and have their books adjusted to meet the tax. A change would make some difference in the bearing of the tax; some corporations would lose by the change and other corporations would gain. It depends on the nature of their business. If you made the change that would of course make a change in the tax of almost all corporations. Without a change they go on the same as before, on the same arrangements as before. Now, from the revenue standpoint it is immaterial.

Senator REED of Pennsylvania. And it would be satisfactory, would it not, to get rid of this capital stock division that you have in the Bureau of Internal Revenue.

Secretary MELLON. Well, of course, they are equipped for taking care of it, and all that. It would not make a great deal of difference that way.

Senator REED of Pennsylvania. It occurs to me that the capital stock tax bears more heavily on corporations that are not prosperous. I have known some corporations whose capital stock tax alone amounted to their entire income for a particular year.

Senator JONES of New Mexico. A great many corporations have no income and have to pay the tax anyway.

Senator REED of Pennsylvania. And if an income tax is sound in theory I do not see why it should not apply to corporations as well as to individuals.

Senator WATSON. And the work could be done in the same department.

Senator REED of Pennsylvania. Yes; and it would establish a definite basis for an income tax, instead of a vague estimated value on the capital stock.

Senator WATSON. Mr. Secretary, would the Treasury oppose a proposition of that character?

Secretary MELLON. Oh, no.

Senator WATSON. Did you express an opinion before the Ways and Means Committee on this matter?

Secretary MELLON. Yes; about the same as I have now.

Senator SIMMONS. You have a proposition to increase the corporation tax.

The CHAIRMAN. I think I shall have to be excused now, on account of an executive session in the Senate.

Senator JONES of New Mexico. Will the Secretary be here this evening?

The CHAIRMAN. No.

Senator JONES of New Mexico. Will there be a meeting of the committee this evening?

The CHAIRMAN. No; Senator Simmons, and some of the other members would find it impossible to be here.

Senator JONES of New Mexico. I wanted to ask the Secretary a few questions, with reference to the floating debt, how you propose to retire the floating debt?

Secretary MELLON. We could give you a statement on that. Senator.

The CHAIRMAN. Then let us adjourn until to-morrow morning at 10 o'clock.

Senator JONES of New Mexico. I wanted to know how you propose to retire the floating debt, these short-term certificates?

Undersecretary WINSTON. I think we could give you that information now.

Senator JONES of New Mexico. I would like to have your deliberate answer to that question.

Undersecretary WINSTON. Of course, the difficulty is that we can not give you a definite answer to-day. We may decide to roll it over for a time. If the conditions remain the same as they are, we will pay off a certain portion of that debt out of the sinking fund.

Senator JONES of New Mexico. I thought that sinking fund had to be applied to these bonds.

Undersecretary WINSTON. That is a part of the floating debt, because they mature in 1928.

Senator JONES of New Mexico. That is not what I refer to as the short-dated debt.

Secretary MELLON. That is now a part of the short-dated debt.

Senator JONES of New Mexico. What I want to get in the record is a real statement of what the Treasury intends to do with these short-dated debt certificates that run for 90 days, or 6 months, or 12 months.

Undersecretary WINSTON. Senator, if conditions remain the same, we may pay it but if conditions change, we may roll it over for a time.

Senator JONES of New Mexico. In other words, you have no program with reference to it?

Undersecretary WINSTON. Yes; we have the program that will save the most money for this country. You can not have a definite program.

Senator JONES of New Mexico. Then you have answered my question. You have no definite program?

Secretary MELLON. That is a definite program, but you can not give a specific answer as to how payments will be made in the future.

Senator JONES of New Mexico. That is exactly what I want to appear in this record, that you have no definite program.

Undersecretary WINSTON. We have the definite program so to handle it as to cost the Government the least interest.

Senator JONES of New Mexico. In your judgment?

Undersecretary WINSTON. Yes; it has got to be somebody's judgment.

(Whereupon, at 3.30 o'clock p. m., the committee adjourned to meet at 10 o'clock a. m., to-morrow, Wednesday, January 6, 1926.)

REVENUE ACT OF 1926

SATURDAY, JANUARY 9, 1926

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

The committee met in room 310, Senate Office Building, at 10 o'clock a. m., pursuant to adjournment, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Reed of Pennsylvania, Stanfield, Wadsworth, McKinley, Shortridge, Simmons, Jones of New Mexico, Gerry, Harrison, King, Bayard, and George.

Present also: Hon. Edgar A. Brown, speaker of the South Carolina House of Representatives.

The CHAIRMAN. The committee will come to order. Mr. Brown we will be glad to hear what you have to say.

STATEMENT OF HON. EDGAR BROWN, SPEAKER OF THE SOUTH CAROLINA HOUSE OF REPRESENTATIVES

Mr. BROWN. Mr. Chairman and gentlemen of the committee, we feel that it is scarcely necessary to present to you gentlemen lengthy arguments in favor of leaving to the States the opportunity and responsibility for levying of death taxes, except as the Federal Government may temporarily levy such taxes in time of acute national emergency. Conclusive arguments in favor of such a policy have been repeatedly presented and particularly emphasized by President Coolidge and by Secretary Mellon. They were briefly but earnestly presented before the Committee on Ways and Means of the House of Representatives by the governors of a number of the States of the Union and supported by the indorsement of the governors of a majority of the States and by officers and members of State legislatures.

Not only is the action which we urge and recommend in line with the historic policy of the Nation and in harmony with our system of government, but the policy is particularly urged and demanded by the conditions of the present time and by the need of additional sources of revenue by the States. It is universally admitted that there are no conditions of emergency requiring the continuation of the levy of estate taxes by the Federal Government, and the continuation of such levy under the circumstances violates every principle of our long-established and generally approved national policy of taxation.

The House of Representatives by its action in the pending revenue bill in reducing the Federal estate taxes by one-half has not only

recognized the almost universal protest against excessive estate taxes, but it has also recognized the general public sentiment in support of the complete abandonment by the Federal Government of this field of taxation. The reduction made by the House is approved, but it does not go far enough. The approval by the House of the inheritance section of the revenue bill is tantamount to an admission that the Government should entirely retire from this field of revenue. But in doing so the Government would say that while it does not need the revenue, and is not expecting to raise any considerable amount of revenue under the terms of the bill, the thing that the Government wants to bring about is that each and every one of the States will be forced, whether they wish to do so or not, to adopt the same inheritance tax that the Federal Government adopts. I take it that none of us need to delude ourselves as to the purpose of the provision in question. Under the provisions of the existing law, the Government levies, in the higher brackets, up to 40 per cent on inheritances, 25 per cent of which may be collected by the State, leaving 75 per cent of the 40 for the Federal Government. But in the present bill the Government would reduce the rate to a maximum of 20 per cent and allow the State to collect 80 per cent of the 20. Or, to put it another way, the State would be allowed to collect 16 per cent and the Government 4 per cent. No one will gainsay the statement that a 4 per cent inheritance tax collected by the Federal Government with the expense of maintaining a department for that purpose, appraising estates, carrying on litigation, etc., will make that department hardly more than self-sustaining. I am informed that the cost of collecting inheritance taxes by the Government is from 1½ per cent to 3 per cent. If this be true, does the Government want to levy a 1 per cent or a 1½ per cent inheritance tax. It is, therefore, conclusive that the the effect is one not to raise revenue for the Federal Government but to force upon the States a rate and system of taxation that may be obnoxious to them.

I take it that the Members of this Congress, elected by the people as national representatives, are here to legislate with regard to national and international affairs, and not to pass regulatory measures to coerce the sovereign States. You may provide revenue, you may originate revenue measures, but revenue for what? For the support of the Federal Government. Are you here to provide revenue and to originate revenue measures for the benefit of the States? By what right does Congress conceive the idea that it is just to pass regulatory measures involving the rights of the State to levy and collect a direct property tax? The States elect their own representatives and send them to the legislatures for that purpose and to determine those questions. It may be true that some inconveniences are arising and perhaps many inequities exist because of the attitude of the different States on the inheritance tax question, but that is a matter for the States. If the Federal Government is going to step in and attempt to adjust every inconvenience or inequity in State laws, then we may as well abandon any effort to maintain the rights of the States and allow Congress to regulate the subjects and rates of taxation in every State.

Every Member of Congress knows, and the people back home know, that this is an effort to do indirectly something which Congress has no right to do directly.

Notwithstanding the arguments that have been made on behalf of the temporary retention of a Federal estate tax at a reduced rate, we are still of the opinion that there are no insurmountable difficulties in the way of an immediate repeal of the Federal estate tax laws. It is true, as above suggested, that there is a lack of uniformity among the States in the matter of taxing estates, but those best informed on the subject are of the opinion that as long as we have States as entities of Government there always will be a lack of uniformity, not only in this but other laws, and that such a lack of uniformity is not only inevitable but to a certain extent wise and justifiable. On the other hand, we are of the opinion that the objectionable features of State inheritance taxes will be more speedily remedied with the Federal Government entirely out of this field of taxation, and that the sooner we return to our historic national policy in this regard the sooner will the States seek and find remedies for the present objectionable duplication and overlapping of inheritance taxes.

While the House of Representatives took a long and commendable forward step in the reduction of Federal estate taxes, it also took a very unfortunate and, in our opinion, wholly indefensible backward step in the provision contained in paragraph (b) of section 300, pages 143 and 144 of the pending revenue bill, under which the tax imposed by the Federal Government shall be credited to the amount of any estate inheritance legacy or succession taxes paid to any State or Territory to the amount of 80 per cent of the Federal tax. This provision is objectionable from many viewpoints. It undoubtedly appeals to those who favor the maintenance of high estate and inheritance taxes, and who desire to have the Federal Government remain in the death-tax field. Undoubtedly it was assumed that those who believe in the principle and policy of leaving the question of the levying of death taxes with the people of the States, this 80 per cent credit is even more objectionable than the failure to entirely repeal the Federal estate tax. Whatever may have been the thought or purpose of those responsible for it, it is in the nature of a bribe and it amounts to a congressional coercion upon the States to harmonize their death taxes and policies with a plan proposed by the Congress without consideration by or consultation with the people of the States and their legislative representatives.

As a matter of national policy, this 80 per cent credit is objectionable, because it makes the Federal Government a revenue collector for the States, leaving the Federal Government in some cases an exceedingly narrow margin of revenue, if indeed it would not in some instances entail an actual loss upon the National Treasury. For what purpose is this 4 per cent levy to be laid by the Government? If its purpose be to tempt, urge, or coerce the States into the enactment of death tax laws in harmony with the view of the Congress thus expressed, it is a wholly unjustifiable act on the part of the Congress. If, on the other hand, it is to be taken as an admission that it is believed that the Federal Treasury needs the revenue that might be secured from a 4 per cent levy on estates, then the law should be amended in accordance with that view and the Federal levy reduced to a 4 per cent maximum. Why? Do the States need supervision at the hands of the Federal Government? Which department is best fitted to do justice to an estate in the matter of returns and appraisements—a Federal department clerk living in

Washington, whose home is in New York (and who is sent to South Carolina to make an appraisement and knows nothing of local conditions), or vice versa, or the tax department of New York or South Carolina, the agents of which are familiar with local conditions and values? Under a Federal appraisement executors of a deceased person are confronted with a formidable volume to fill out in triplicate (which a Philadelphia lawyer couldn't understand), answering an infinite number of questions, and the return is always checked by an agent of the department, bound by hard and fast rules from Washington, with no power to decide any controverted question, but with infinite zeal for revaluing the property with respect to which he probably has no means of making an intelligent appraisal. The executors are indeed fortunate if they can settle the Federal tax question without reams of correspondence with the authorities (which often remain unanswered for months) with the assistance of his lawyers and usually trips to Washington, without accepting a number of injustices in connection with the appraisal of property or the interpretation of the law, which they realize it would be cheaper to accept than litigate over, for if the estate's representatives are unwilling to accept a ruling by some department clerk or head which they consider unjust, their only redress is a series of appeals and court litigation which may cover a period of years. I know of cases where in order to collect a hundred or two dollars in Federal inheritance tax the Government has spent hundreds and hundreds of dollars in appraisements, reappraisements, and litigation and caused those interested untold expense and worry. Annoying rulings are constantly being promulgated by the lesser officials.

Here is an instance of wrongdoing on the part of the department here in Washington the like of which will continue as long as the Government stays in this particular field of taxation, and particularly if under the pending bill the Government is to make all appraisements and fix regulations surrounding the collection by the Federal and State governments of this tax. It is an almost universal practice in the States for married men to have the title to the family home placed in the wife's name, and it has generally been held by the courts that in such case the wife has complete and indefeasible title. When the husband dies the home under such circumstances is no part of his estate. The estate tax authorities have, however, ruled that in case a husband buys a home for his family and puts the title in his wife's name perhaps many years before his death, the home remains part of his estate for the purpose of the Federal estate tax, if the husband and wife continue to occupy it together until his death, on the theory, apparently, that the wife does not begin to enjoy the home until she has either turned her husband out of doors or he has died. It is the constant necessity of struggling against rulings of this character, of unwarranted increases in the valuation of property, and the delays in securing final decisions rather than the amount of the tax that have caused the estate tax to become the bane of those who are trying to settle moderate-sized estates. It is often found, after long-drawn out correspondence and perhaps litigation, all usually caused by some clerk's ruling, that no inheritance tax whatever is due the Government. This condition serves to illustrate what most of us know by experience, that the inheritance tax department of the Federal

Government has caused the people of this country more trouble and worry than any other department of the Government which deals directly with the people. And this accounts largely for the unpopularity of the law and the almost universal demand for the Federal Government to get out of that field of revenue.

The collection by State authorities of inheritance taxes is accomplished with little friction or hardship. The forms are simple. The department heads are familiar with values, people, and conditions. The heads of the inheritance tax division are to be found every day at the State capitol, accessible to any citizen, and any difficult question can be ironed out without trouble. If a legal question arises the State statute is simple and the question can be promptly determined.

Another and the more serious objection to the plan of what practically amounts to a joint Federal and State levy is the unwarranted and woeful extension of Federal centralization. The States should retain jurisdiction and direct supervision over all sources of revenue that may properly be classed as State revenue measures. The inheritance tax is a direct property tax, a field which the Federal Government has entered only on the occasion of war emergency, and always heretofore has withdrawn when the reason for such unusual taxation has ceased. The great World War has ended—the emergency is over, and the Government has no longer need for this extraordinary tax.

And what of the infringement of the rights of the States? Is there justification for this apparently unwarranted invasion of the rights of the States? We claim not. Is the question of States rights raised in this matter? We claim that it is. Is there any such thing as the rights of the States? Statesmen all rave over the rights of the sovereign States to exercise this, that, or the other power and then some of them go ahead and vote to the contrary. There has been so little real protest against the invasion of State rights of late years that it almost appears that the States have lost these rights by laches. Beveridge's History of the Supreme Court of the United States fully depicts the swing of the pendulum for and against the rights of the States. At one period of our history the tendency is toward invasion of these rights by the Federal Government, and at another, the swing is back to the Constitution. The various interpretations of the commerce clause of the Constitution is a fair illustration of how far we have gone in one direction. The tendency, however, at this time, is the other way. To-day, however, we are not so jealous of our rights as our forefathers were. They had lived and fought and struggled to secure the blessings of liberty and they were determined to enjoy the benefits of their hardships and experiences, and so resented grossly an encroachment upon the rights that they had secured. But as time passed these pioneers passed also, only to be followed by others less experienced in hardships and struggle, and more accustomed to ease and luxury. Those who came after them were correspondingly indifferent to the principle which the fathers had fought for. The growth of the country developed a national outlook. It was accentuated when, as we grew, we began to play an important part in the affairs of the world. Our national pride was stirred and our participation in the World War was the full development of this spirit.

It is not to be unexpected, therefore, that we find among us those who are willing to drift from the original purposes of the Constitution and make dangerous departures from the theory that there are strongly defined lines of demarcation between Federal and State functions.

It is only necessary on this question to recall the ninth and tenth amendments to the Constitution:

> The enumeration in the Constitution of certain rights shall not be and construed to deny or disparage others retained by the people.
>
> The powers not delegated to the United States by the Constitution, not prohibited by it to the States, are reserved to the States, respectively, or to the people.

But we drifted into the interstate commerce act, the Sherman Act, the Federal employers liability act, the Federal water power act, and others, all of which to some extent was an encroachment, as was the attempt to legislate nationally on child labor. Many of these acts undertake to do, in whole or in part, that which could be better done by the States.

Then along another line we have drifted further than was attempted in the above-enumerated acts. The highway construction act of 1916, the Smith-Lever Act, the Sheppard-Towner Act, all edging into activities that more properly belong to the State. I have never thought much of these 50-50 mess of pottage acts by Congress.

Mr. Chairman, I file with the committee as a part of this brief—

(*a*) Compilation of expressions of opinion on this subject, including 4,239 members of State legislatures, a great majority of the speakers of State legislatures and governors of States. These speak for themselves.

(*b*) A list of the individual members of State legislatures who have indicated their opposition to the Federal inheritance tax.

(*c*) Copies of letters and telegrams received since the above information was compiled yesterday morning, from other members of legislatures, speakers, and governors, who also desired to be recorded against this measure.

In conclusion, Mr. Chairman and gentlemen of the committee, I desire to say, first, personally and officially, and as representing the committee of speakers, and speaking what I believe to be the sentiment of the great majority of State representatives and governors who have expressed themselves on this subject, as a matter of principle and as a matter of democracy, the Federal Government has no right in the inheritance tax field. It is a field which the State ought to have to itself. Fundamentally it is a tax upon the right to inherit. That is the theory upon which the courts have held that it can be legally justified. That being true, it is the State which gives its citizens the right to inherit and protects them in that inheritance, and the State is the only authority which can morally and legally exact a death tax.

(Evidence in support of the statement of Hon. Edgar A. Brown, speaker of the house of representatives of South Carolina in opposition to the Federal inheritance tax is here printed in full as follows:)

EXPRESSIONS OF OPINIONS BY GOVERNORS, OFFICERS AND MEMBERS OF STATE LEGISLATURES IN OPPOSITION TO A FEDERAL INHERITANCE TAX AND PARTICULARLY TO THE INHERITANCE SECTION OF THE REVENUE BILL NOW PENDING BEFORE CONGRESS

[Compiled by the Hon. Edgar A. Brown, speaker of the South Carolina House of Representatives, acting for a committee of speakers appointed at a meeting of State representatives held in Washington, D. C., December 10, 1925, filed with the Finance Committee of the United States Senate, January 9, 1926.]

RALEIGH HOTEL,
Washington, D. C., December 10, 1925.

To the legislatures of all States in the Union, and the people thereof:

We, the speakers of the house of representatives and presiding officers of the senate of the legislatures of the States of Texas, Alabama, Arkansas, Delaware, Kentucky, Louisiana, Maryland, Michigan, North Carolina, Rhode Island, South Carolina, and Virginia, together with the chairmen of the fiscal affairs committee of these legislatures, and other legislators assembled in Washington, acting unofficially, address this memorial to the legislatures of the several States of the Union and to the sovereign people of the States, asking them to join with us in this petition to the Congress of the United States.

Through observation and experience in legislative matters affecting the several States, we have come to the conclusion that the freedom of action of State governments, as contemplated by the Constitution under our form of dual sovereignty, is being gradually but vitally limited by and through certain legislative policies of Congress.

In particular, we call your attention to that proposal in the new revenue bill presented this week to the House of Congress by the Ways and Means Committee, providing for crediting the Federal estate tax with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State, the credit allowed not to exceed 80 per cent of the total amount levied by the Federal Government. The effect of this proposal is to force all the States of the Union to enact estate or inheritance tax laws patterned after the Federal act in order to keep within the States at least 80 per cent of the total levied by the Federal Government.

For several years we have viewed with more or less alarm the tendency of our Federal Congress to encroach upon the rights of States in their legislative functions, but we consider this proposal in the new Revenue Bill now pending before the House of Congress the most far-reaching piece of legislation ever seriously proposed by Congress to take from the States the real earmarks of sovereignty—their rights to levy and collect taxes for the support and maintenance of their own departments, institutions, and activities. Its passage by Congress would destroy the spirit of the laws of succession in the several States.

As representatives of the peoples of the several States, we have labored through many years with problems that cause us to acclaim heartily the following declarations of the President in his message of December 8 to Congress:

"The functions which the Congress ought to discharge are not those of local government but of National Government. The greatest solicitude should be exercised to prevent any encroachment upon the rights of the States or their various political subdivisions. Local self-government is one of our most precious possessions. It is the greatest contributing factor to the stability, strength, liberty and progress of the nation. It ought not to be infringed by assault or undermined by purchase. It ought not to abdicate its power through weakness or resign its authority through favor. It does not at all follow that because abuses exist it is the concern of the Federal Government to attempt their reform."

Through many years of labor in legislative bodies of the States that make up this Union we have continually confronted the barricade of Federal encroachment upon our rights. With each succeeding legislature we have seen this tendency grow from a very small beginning to its present alarming proportions.

As representatives from these typical American States and with full knowledge of conditions that exist in Washington, we confess we are greatly alarmed as to the future of these United States. The initial paragraphs of the President's message to the Sixty-ninth Congress find us fully in accord. We firmly believe, with Congress's action as our example, that there is so definite a trend toward centralization in this Government that all citizens of the Republic may well be alarmed.

In that spirit, as one with you, we call your attention to this state of affairs in the Nation as it affects the several States, and we ask you to join with us in this

petition to Congress that it heed our prayers and find a way to return to the 48 States dominion over their own affairs.

We call upon Congress to reject the joint levy proposed by the House committee and demand the immediate abandonment of inheritance tax by the Federal Government, as recommended by Secretary Mellon, leaving this source of revenue to the States to use in their own way.

We instruct the secretary of this meeting to send a copy of these resolutions to the President of the United States; members of the Cabinet; Members of Congress; governors of States; lieutenant governors; speakers of the houses, and to the members of the several State legislatures.

Texas: Lee Satterwhite, speaker of house; Robert A. Stuart, State senator; John Davis, chairman, senate finance committee; George C. Kemble, representative.
Alabama: Hugh D. Merrill, speaker of house.
Arkansas: Robert Bailey, State senator; Thos. A. Hill, speaker of house.
Delaware: Henry C. Downward, speaker of house.
Kentucky: S. W. Adams, State senator; R. R. Rogers, representative; John Cushing, representative.
Louisiana: A. W. Dalferes, representative.
Maryland: Francis P. Curtis, speaker of house; Franklin Upshur, representative.
Michigan: Fred B. Wells, speaker of house.
North Carolina: Edgar Pharr, speaker of house; P. H. Williams, chairman, senate finance committee; N. A. Townsend, chairman, house finance committee; W. R. Matthews, representative.
Rhode Island: Arthur A. Sherman, president pro tem, senate; Chas. R. Easton, representative.
South Carolina: Edgar A. Brown, speaker of house; Carroll H. Nance, chairman, house finance committee.
Virginia: Boyd R. Richards, representative.

RESOLUTION PASSED AT CONFERENCE OF REPRESENTATIVES OF LEGISLATURES IN SESSION AT WASHINGTON, D. C., DECEMBER 10, 1925

Resolved, That the Chair be authorized to appoint a committee to examine all bills introduced in Congress proposing joint levies and appropriations involving acts of State legislatures;

That said committee should be instructed to report to governors, speakers of the house and presiding officers of the senate, any proposed legislation by Congress that in any manner invades the rights of States.

The following committee was appointed: Arthur A. Sherman, chairman, president pro tempore of the Rhode Island Senate; Edgar A. Brown, speaker of the South Carolina House of Representatives; Henry C. Downward, speaker of the Delaware House of Representatives; S. W. Adams, State senator from Kentucky; Francis P. Curtis, speaker of the Maryland House of Representatives.

PROTEST FROM 4,280 MEMBERS OF STATE LEGISLATURES OPPOSING FEDERAL INHERITANCE TAX PROVISION AND 41 FAVORING

An incomplete poll of the individual members of State legislatures throughout the United States, covering all the States except Florida, Pennsylvania, Vermont, and Alabama, develops the following percentage of sentiment expressed by the members as opposed to the Federal inheritance tax. Florida and Alabama were not polled because they have a constitutional inhibition against the inheritance tax. Pennsylvania and Vermont were not polled because the legislatures in those States have recently passed resolutions opposing the Federal inheritance tax. In no State has there been any expressed opposition by members of the legislature. We have perhaps, in rare instances, of three or four from a State. The canvass to date shows the following percentages:

States listed in order of percentages opposed

State	Per cent
Over 70 per cent:	
Delaware	76
Connecticut	72
Nevada	70
Texas	70
From 60 to 69 per cent:	
Wyoming	67
Louisiana	66
Indiana	65
New Mexico	64
North Carolina	64
New Hampshire	60
From 50 to 59 per cent:	
Arkansas	59
Ohio	58
Kansas	57
Maryland	57
Maine	56
Michigan	55
West Virginia	55
Colorado	54
Tennessee	54
Montana	53
New Jersey	53
From 50 to 59 per cent:	
Oregon	53
South Carolina	53
Utah	53
Georgia	51
Illinois	51
Missouri	50
From 40 to 49 per cent:	
Rhode Island	49
South Dakota	49
Mississippi	48
Arizona	47
Massachusetts	45
Idaho	43
New York	43
North Dakota	42
Under 40 per cent:	
California	38
Virginia	38
Washington	35
Minnesota	33
Wisconsin	27
Nebraska	24
Kentucky	21

The canvass is still under way, and we feel certain that at least 75 per cent of our legislators in all States will express their opposition to a Federal inheritance tax and that not more than 1 per cent will be in favor of it.

A majority of the speakers of the various houses of separate States have indicated their opposition to this measure. Some of these, however, are being sent in by wire, and in order to place a complete list in the record of the speakers who desire to be recorded in opposition to this measure, a list will be prepared and filed later along with protests from other members of State legislatures and governors as they come in.

PROTESTS FROM 22 GOVERNORS

EXECUTIVE DEPARTMENT,
Annapolis, Md., December 30, 1925.

Hon. EDGAR A. BROWN,
Speaker, House of Representatives,
Columbia, S. C.

DEAR MR. BROWN: I have your favor of December 23, relative to the proposed Federal estate tax, and I am very much obliged to you for it. I quite agree with you in disapproving the proposition as it passed the House, and will be glad to get in touch with the Maryland Senators in regard to it.

With best wishes for the New Year, I am,

Very truly yours,

ALBERT C. RITCHIE, *Governor.*

FROM GOV. ANGUS W. M'LEAN, OF NORTH CAROLINA

I have just observed the recommendation of the House Ways and Means Committee on inheritance taxes. I confess I do not think that this plan if enacted into law will work out in practice. I am thoroughly convinced that it would be best for Congress to abandon the inheritance tax altogether as a source of Federal revenue or reduce the tax to a minimum, allowing the States free to levy a tax either upon the transfer of the estate or upon inheriting the property. I think the principle involved of having Congress dictate to the States the rate and manner of levying these taxes establishes a very bad precedent.

FROM GOV. TOM J. TERRAL, OF ARKANSAS

I am pleased to acknowledge receipt of your letter of December 29th. We in Arkansas, are opposed to the inheritance section of the present revenue bill pending before Congress. We feel that it is a matter which should be left to the various States.

A meeting is being held in Little Rock to-day, called by the Speaker of our House of Representatives for the purpose of discussing the inheritance tax question.

FROM GOV. J. E. ERICKSON, OF MONTANA

I am in receipt of your letter with inclosures, in regard to the revenue bill now pending before Congress, and note your comments thereon. I shall be very glad to take this matter up with our congressional delegation and lay the matter before them as you suggest. I believe that you are entirely right in this matter, and I shall be very glad to cooperate with you in any way I can.

FROM GOV. ALVAN T. FULLER, OF MASSACHUSETTS

There is no justification for the Federal Government to continue the tax on inheritances for purposes other than revenue, nor should taxing officials seek to accomplish any other result under the guise of taxation.

Massachusetts early established for its people the right of the devolution of property. It set up and maintained probate courts and other governmental agencies to insure the privilege granted by the Commonwealth to the dead to transmit property to the living. It is well recognized that to obtain revenue with which to conduct its governmental functions the State has a valid right to tax a privilege granted. In this respect the States stand alone because they, and they only, grant the privilege to their people to pass property at death to those upon whom they wish to bestow their bounty. It seems clear that the laying of death duties should be exclusively a State function, and one that should not be interfered with or modified by the Federal Government except in those days of need when all the resources of the States must be freely granted to the United States to the end that they all may be preserved.

There are other revenue fields open to the Federal Government that are closed to the State governments, and it does not fit well into our scheme of cooperation to have a strictly State source invaded by the Federal Government, especially at a time when the revenue is not needed by the Federal Government but sadly needed by the States themselves. Massachusetts has the machinery to protect its citizens in the devolution of property, a privilege which the State has granted; it feels that if tax exaction is laid with every degree of fairness, it represents both as to itself and as to its citizens the continued occupancy of this tax field by the Federal Government and earnestly desires a speedy retirement from this field by the United States fiscal authorities. Every effort should be made by Congress to repeal all Federal death duties and Massachusetts is so deeply affected that it should render every assistance to bring this about. There is no benefit to be derived from any other disposition of the estates tax which has caused loss of needed revenue to the States and irritation to its citizens.

FROM GOV. GEORGE S. SILZER, OF NEW JERSEY

I have your letter of December 23, with inclosure. I have for two years sent communications to our legislature, recommending the course which you suggest, but without result. I shall take the same action in my coming message, and hope that we will get the necessary cooperation. You know, of course, that I have always cooperated on this subject.

I quite agree with you that the inheritance matter will largely destroy the sovereign right which every State has "to designate the sources of its revenues for State purposes." In other words, it appears to be an effort toward a woeful invasion of the rights of the States.

It seems to me that we have been derelict in many other ways, and have made little or no opposition to this invasion of State's rights.

FROM GOV. GEORGE W. P. HUNT, OF ARIZONA

That portion of the House revenue measure dealing with the subject of inheritance taxes seems to me to warrant close scrutiny and consideration.

I know that you gentlemen are as familiar as I am with the subject of Federal control over large areas of our State and of all Western States and that you know the blighting effect this control has had upon our livestock and mining industries.

I am a thorough believer in the doctrine of State rights. I believe it to be the only fundamentally sound policy that can retain for the people of these United States the best type of government yet conceived by man. The States do not need and do not want to foster the hand of bureaucracy. Scarcely a question of large public import arises these days when some one does not stand up in his place and pass the thing up to the President of the United States to find a solution; and that applies whether it be to questions of public policy or to questions affecting private industry.

We find it illustrated and typified in the question of the Colorado River controversy and in the coal strike. What is going to become of the self-reliance and creative spirit of the American people, if that is to become the basic policy of our governments?

That provision of the revenue bill which proposes that the Federal Government shall collect an inheritance tax and return 80 per cent of it to the States, irrespective of the States' wishes in the matter, is, to my mind, fundamentally wrong. It is asserted that that provision is adopted partly because of the action of the State of Florida in providing for the elimination of the inheritance tax.

Why should Florida be compelled to levy an inheritance tax if she does not wish it? Why should not the people be permitted to live in Florida and maintain their residence there if they so desire? Citizenship carries with it many privileges and responsibilities; and if a man, in order to avoid inheritance tax, takes up his residence in Florida, it seems to me that he runs the risk of a policy being adopted by the State in which his property is located which may dissipate his wealth and ruin his enterprises.

But, even if that were not so, I do not believe that the Federal Government should undertake to arrange taxation questions for the States. I am advised that a program is under way to urge Congress to pass a uniform law taxing gasoline, based upon the same theories as those underlying the inheritance taxation.

If this policy is followed out to its logical conclusion, State governments will be rendered impotent. I thoroughly believe that the sooner the Federal Government is eliminated, as far as possible, from the control over the affairs and areas of the various States, the better it is going to be for the people of the United States and the longer they are going to retain their liberties. If a few State governments set up machinery to aid tax dodgers, I believe there is enough ingenuity still left in the American people to resort to measures adopted through their various State governments to conserve and protect the welfare of their citizens.

I give you these views for what they may be worth in connection with the pending legislation.

FROM GOV. CLARENCE J. MORLEY, OF COLORADO

I am opposed to the Federal inheritance tax law and trust it may be repealed.

I favor making inheritance tax laws, if any, a matter of local option or determination by the several States.

FROM GOV. JOHN H. TRUMBULL, OF CONNECTICUT

In reference to your letter of December 23, regarding the inheritance tax situation, I passed this on to our tax commissioner, Mr. William H. Blodgett, who I consider one of the authorities on this subject, not only in Connecticut but in the country, and I am forwarding to you his letter in which he reported to me on the subject.

I think this matter is covered very thoroughly in the commissioner's letter, and if you desire any further information I would suggest that you might communicate direct with Commissioner Blodgett, who, I feel sure, will be very glad to cooperate with you as far as possible.

LETTER OF TAX COMMISSIONER BLODGETT TO GOVERNOR TRUMBULL

His Excellency JOHN H. TRUMBULL,
Governor of Connecticut, Hartford, Conn.

DEAR GOVERNOR: I am this morning in receipt of your note of the 28th instant inclosing therewith a communication from Hon. Edgar A. Brown, speaker of the House of Representatives of the State of South Carolina. This letter calls attention to the provisions of the inheritance-tax section of the new revenue bill which is pending before Congress.

I presume you will remember that Secretary Mellon and the President recommended the immediate repeal of the Federal inheritance tax law. I believe this is the course that Congress should take. It is particularly pleasing to me to be able to agree with the stand which is taken in this matter by South Carolina and many other of the Southern States. The same stand is taken, too, by many of the Northern States.

I have not at hand a copy of the proposed revenue bill, so I am unable to quote to you therefrom. It provides, however, that a credit up to 80 per cent of the Federal estate tax be allowed for State inheritance and estate taxes paid. In most instances this means a net yield to the Federal Goverment of 20 per cent only. The point is that there are rights which belong to the individuals. Such a measure proposes to slice from the decedent's estate, with no net gain to the Federal Government or to the States, a portion of his property as a measure upon States which do not fall in line with State inheritance taxation. In other words, if a State chooses to have no inheritance taxation—and it is privileged to make such choice—it is required to pay a Federal inheritance tax which will substantially equal the amount collected by other States which do collect money from an estate tax law. This is a plain case of coercion of States. One of these States is Florida, another is Nevada, and there may be one or two more.

This provision of the proposed law will have little effect in Connecticut. Such effect as it may have, in my judgment, will be to reduce the amount of the Federal inheritance tax which is paid by the estates. In arriving at the net taxable estate in Connecticut the amount paid or to be paid to the Federal Government is allowed as a deduction. On the contrary, in computing the Federal tax the amount paid or to be paid to the State is allowed as a deduction in arriving at the net taxable estate. At the present time when the net taxable estate of a Connecticut decedent is ascertained for the Federal estate tax, the Federal Government allows a credit of not exceeding 25 per cent of the Federal estate tax figure if the Connecticut inheritance tax amounts to 25 per cent thereof. The new law proposes that in lieu of 25 per cent credit a credit of 80 per cent shall be allowed.

In the application of the law as proposed, difficulty is foreseen. Agents of the United States Government, taking their instructions from Washington, altogether too often are unable to apply such instructions in specific cases in a way to harmonize the problems of administration. Such agents must take up questions which arise with Washington. No stereotyped regulation or rule can be drawn which is applicable to the exigencies which arise in the settlement of estates throughout the country. We have already encountered difficulty in this regard. Administrators and executors of estates meet similar difficulties.

FROM GOV. CLIFFORD WALKER, OF GEORGIA

I desire to say for myself, representing the State of Georgia, that our people are earnestly back of the resolution signed by the 32 governors. We feel that this is a field within the exclusive jurisdiction of the States, in the matter of taxation. We believe that this Federal inheritance tax can not and could not have been passed but as a war measure; that it is a matter that should be left to the States. We hope Congress will retire from that field.

FROM GOV. FRANKLIN S. BILLINGS, OF VERMONT

I have your letter of the 23d and agreeable to your request I have written to Senator Dale in regard to the inheritance section of the revenue bill. I can speak very frankly that it will not be, as drawn, satisfactory to the State of Vermont.

FROM GOV. AARAM J. POTHIER, OF RHODE ISLAND

Permit me to acknowledge the receipt of your letter of December 28 relative to inheritance tax.

In my opinion, this is a matter for State jurisdiction, and I will be pleased to transmit your letter to our legislature.

FROM GOV. WILLIAM W. BRANDON, OF ALABAMA

I regret exceedingly that I was unable to attend the meeting of the Country Bankers' Association recently held in Georgia.

I am in receipt of your letter of June 28 and a copy of the resolution adopted. I concur in the resolution as passed.

FROM THE SECRETARY OF STATE FOR DELAWARE

Replying to your recent letters, would advise that Gov. Robert P. Robinson has authorized me to advise that he is opposed to that portion of the Federal inheritance tax which taxes the estates of decedents, and believes that these provisions should be repealed.

I note that Senator Bayard has already advised you that he is opposed to that portion of the Federal inheritance tax, but as yet I have had no reply from Senator du Pont.

FROM GOV. LEN SMALL, OF ILLINOIS

I am in receipt of your favor stating the purported views of Chairman Green of the House Ways and Means Committee and Congressman Garner regarding the Federal inheritance tax.

I am sorry to hear of the position which these gentlemen are credited with taking, as I had hoped, and still hope, that Congress, with its unlimited means of securing funds without direct taxation, would repeal the Federal inheritance tax law and leave that source of revenue for the use of the States.

I firmly believe that Congress should take this action and will be glad to do what I can toward accomplishing that end.

FROM GOV. MIRIAM A. FERGUSON, OF TEXAS

I favor the repeal of the present inheritance tax provision of the present Federal tax measure, leaving this source of revenue to the States for individual action as they see fit.

FROM GOV. BEN S. PAULEN, OF KANSAS

Governor Paulen asked me to say to you that he is in favor of asking Congress to repeal the Federal estate tax, leaving this source to be handled entirely by the States.

FROM GOV. WILLIAM J. FIELDS, OF KENTUCKY

Confirming my telegram of even date, I have just read copy of the resolution on Federal inheritance tax passed by the Georgia Country Bankers Association at Savannah, Ga., June 18.

I am glad to give my hearty indorsement to these resolutions and desire to thank you for your courtesy in forwarding copy of same to me.

FROM GOV. HENRY L. FUQUA, OF LOUISIANA

In reply, I wish to state that Louisiana is already on record in opposition to the Federal inheritence tax, our legislature of 1921 having adpoted a concurrent resolution memorializing Congress to repeal the Federal estate tax. While this resolution was adopted prior to my administration, I feel that I should respect the wishes of the people of this State, as expressed in the resolution quoted.

FROM GOV. HENRY L. WHITFIELD, OF MISSISSIPPI

Replying to your request that I inform you of my position relative to the Federal Government levying an inheritance tax, I am in favor of the inheritance tax being solely a State tax, leaving this source of revenue to the States to deal with as they see fit.

FROM THE STATE TAX COMMISSIONER OF NEW MEXICO, BY DIRECTION OF GOV. A. T. HANNETT

As a member of the State tax commission of this State, will state that this commission is very much interested in the matter of inheritance taxes and it is our intention to exert every effort in the matter and cooperate in every way possible with other States, and agencies looking to the repeal of the Federal inheritance tax. The matter will be brought to the attention of our Representatives in the Congress, who will give the matter their serious consideration.

FROM GOV. J. E. ERICKSON, OF MONTANA

I am opposed to a measure of this kind, believing that the matter should be left to the States solely.

FROM GOV. A. G. SORLIE, OF NORTH DAKOTA

I am opposed to any laws that serve to take away State rights. I believe in an inheritance tax and I hope it may be possible for the States to adopt a uniform tax measure, but I feel very strongly that the States should control such matters themselves.

FROM GOV. THOMAS G. M'LEOD, OF SOUTH CAROLINA

In regard to the inheritance tax, I feel that the Federal Government should retire from this field of taxation entirely, leaving it to the States to deal with as they see fit.

FROM GOV. CARL GUNDERSON, OF SOUTH DAKOTA

After considering the matter carefully and after receiving a statement from the director of our tax commission, Judge B. W. Baer, I am prepared to state that I am opposed to a continuation of the Federal inheritance tax law. I am firmly convinced that each State can better administer this form of taxation to better advantage than can be done by the Federal Government, and I am not in favor of the Federal Government collecting this tax for the State.

FROM GOV. AUSTIN PEAY, OF TENNESSEE

Of course, there is no excuse whatever for a Federal inheritance tax during peace time. That tax in our State is a privilege tax, not an ad valorem tax levied and collected for the devolution of property under our laws, and, of course, no title can ever pass under the Federal statute, but is taken always under the laws of the State where the property is situated.

FROM GOV. E. LEE TRINKLE, OF VIRGINIA

I am certainly in favor of the States being given this field of taxation and have long since advocated the same on numerous public occasions. In making this statement I do not want to be understood as being in favor of the States yielding up their rights to place an income tax. A great many of the States have built up their taxation system with the income tax as a very important part of their revenues, and before any change should be made in this, most serious consideration should be given to the matter. The reason that I refer to the income tax is that I see some suggestion that the Federal Government will contend for this field exclusively.

FROM GOV. ROLAND H. HARTLEY, OF WASHINGTON

The resolution passed by the bankers association convention at Savannah, Ga., July 18, 1925, is in entire accord with my formerly expressed opinion; also with the ideas of the supervisor of inheritance tax in this State, and, I believe, in accordance with the opinion of the great majority of the people of the State of Washington.

Heretofore the Federal estate tax has been adopted as a war measure for the purpose of collecting funds immediately for such emergency purposes, and heretofore the tax has been discontinued as soon as such emergency has ceased to exist. There seems to be no reason why this form of taxation should not now be terminated as soon as possible. Furthermore, it seems to me that the different States should get together and adopt a more equitable and uniform method of inheritance taxation and avoid the double taxing of the States and reduce the burden to such a degree that inheritance-tax collections could and would be handled without the present hardship upon the States and extra labor and official work in making the collections.

In considering the question of inheritance tax, as well as other methods of taxation, we should not be carried away by popular clamor to levy unreasonable toll upon large incomes and large estates. In taxation matters, as well as in anything else, we can't lift ourselves by our bootstraps. It must be borne in mind that no matter upon whom the levy is made, in the end taxes are paid by everybody. When taxation schedules become so large as to render investments uncertain, to cripple industry, and to take away the incentive to accumulate, we no longer have taxation but confiscation, which precludes all progress, all growth, and development.

At a conference of Governors in Savannah, Ga., on June 18, 1925, the following resolution was adopted and 32 governors subscribed or authorized their names to be subscribed thereto:

"*Be it resolved;* That the inheritance-tax provision of the present Federal tax measure be repealed, leaving this source of revenue to the States for individual action as they may see fit.

"Hon. William W. Brandon, Alabama; Hon. George W. P. Hunt, Arizona; Hon. Tom J. Terral, Arkansas; Hon. Clarence J. Morley, Colorado; Hon. John H. Trumbull, Connecticut; Hon. Robert P. Robinson, Delaware; Hon. John W. Martin, Florida; Hon. Clifford Walker, Georgia; Hon. Lem Small, Illinois; Hon. Ben S. Paulen, Kansas; Hon. William J. Fields, Kentucky; Hon. Henry L. Fuqua, Louisiana; Hon. Albert E. Ritchie, Maryland; Hon. Alvan T. Fuller, Massachusetts; Hon. Theodore Christenson, Minnesota; Hon. Henry L. Whitfield, Mississippi; Hon. J. E. Erickson, Montana; Hon. James G. Scrugham, Nevada; Hon. George S. Silzer, New Jersey; Hon. A. T. Hannett, New Mexico; Hon. Alfred E. Smith, New York; Hon. Angus W. McLean, North Carolina; Hon. A. V. Sorlie, North Dakota; Hon. Arma J. Pothier, Rhode Island; Hon. Thomas G. McLeod, South Carolina; Hon. Carl Gunderson, South Dakota; Hon. Austin Peay, Tennessee; Hon. Miriam A. Ferguson, Texas; Hon. George H. Dern, Utah; Hon. Franklin S. Billings, Vermont; Hon. E. Lee Trinkle, Virginia; Hon. Roland B. Hartley, Washington."

Speakers and presiding officers of senates who have indicated their opposition to the inheritance tax provision of the revenue bill

State	Presiding officer of senate	Speaker of house
Alabama		Hugh D. Merrill.
Arizona	Mulford Winsor	Chas. E. McMillan.
Arkansas	S. B. McCall	Thos. A. Hill.
California		Frank A. Merriam.
Connecticut	J. Edwin Brainerd	Elbert L. Darbie.
Delaware		Henry C. Downward.
Florida		A. Y. Milan.
Georgia	J. H. Ennis	
Idaho		W. D. Gillis.
Illinois		David E. Shanahan.
Indiana	Jas. J. Najdi (president pro tem)	
Kansas		Chas. E. Mann.
Louisiana	Philip H. Gilbert	
Maryland	David G. McIntosh, jr.	Francis P. Curtis.
Michigan		Fred B. Wells.
Minnesota	W. I. Nolan	
Mississippi		Thos. L. Bailey.
Missouri		Jones H. Parker.
Nebraska		Allan G. Burke.
Nevada	R. H. Cowles (president pro tem)	A. S. Henderson.
New Hampshire		Geo. A. Wood.
New Jersey	Wm. H. Bright	
New Mexico		D. W. Smith.
New York	Seymour Lowman	
North Carolina		Edgar W. Pharr.
Ohio	Joseph R. Gardner	Harry D. Silver.
Rhode Island	Arthur A. Sherman (president pro tem).	Philip C. Joslin.
South Carolina		Edgar A. Brown.
Vermont	W. K. Farnsworth	Roswell M. Austin.
Virginia		Richard L. Brewer.
West Virginia	M. Z. White	E. M. Keatley.

LIST OF STATE LEGISLATORS WHO HAVE SIGNIFIED BY MAIL OR WIRE, SINCE THIS COMPILATION WAS MADE, THEIR OPPOSITION TO THE INHERITANCE TAX PROVISION OF THE REVENUE BILL NOW PENDING

J. W. Butler, Tennessee representative.
Fessenden L. Ives, Connecticut representative.
J. R. Westbrook, Texas representative.
C. E. Nicholson, Texas representative.
J. W. McCleish, Tennessee representative.
J. Francis Lochard, Indiana senator.
William B. Ormsbee, Michigan representative.
J. W. Stevenson, Texas representative.
Hugh S. Bryer, West Virginia representative.
J. L. Johnson, Michigan representative.
B. B. Hoskins, sr., Texas representative.
L. W. Hunt, Ohio representative.
W. R. Poage, Texas representative.
L. G. Bradford, Indiana senator.
W. A. Joiner, New York representative.
J. C. Albritton, Texas representative.
Ben D. Brown, West Virginia representative.
Jacob Bender, Nebraska representative.
J W. Kinnear, Texas representative.
I. N. Tabbals, Connecticut representative.
J. E. Eastgate, North Dakota representative.
Charles S. Adams, New Hampshire representative.
W. A. Street, West Virginia representative.
J. G. Schwing, Indiana representative.
Edgar C. Daineld, New York representative.
L. E. Carlson, Indiana representative.
Edna C. Fenniman, Connecticut representative.
D. S. Hollowell, Texas representative.
A. I. Mitchell, Connecticut representative.
Charles E. Byars, Nebraska representative.
Alice Pattison Merritt, Connecticut senator.
Guy B. Murray, Ohio representative.
G. W. Coady, Texas representative.
John W. Holliday, Missouri representative.
E. W. Pickett, Connecticut representative.
Perry F. Buckle, Wyoming representative.
George A. Blanchard, New Hampshire representative.
C. L. Heaberlin, West Virginia representative.
Frank D. Fuller, Tennessee representative.
E. A. Piper, Maine representative.
E. C. Gray, Texas representative.
Fermor Barrett, Georgia representative.
H. Thane, Arkansas representative.
David P. Dellinger, North Carolina representative.
Franklin Upshur, Maryland representative.

There was filed with the committee for its perusal an individual list giving the names of 4,239 State representatives protesting against the inheritance tax feature of the revenue bill.

The following resolution was filed with the committee after being presented by the Hon. Mr. S. B. McCall, lieutenant governor, and Mr. Thomas A. Hill, speaker of the house of representatives, of the State of Arkansas.

"RESOLUTION

"With no purpose of resurrecting issues which once divided the Nation, but viewing with alarm the proposed encroachment of the Federal Government upon what has been from the beginning of American democracy the prerogative of the sovereign State to levy and collect its own taxes as assessed against property for the support of the State government—a function which, in our opinion, must remain exclusively that of the State to exercise independently—we confess to serious concern for the future of both the Nation as a whole and the separate Commonwealths comprising it if the far-reaching principles involved in the Federal revenue bill now pending before Congress, particularly with reference to the inheritance-tax feature thereof, providing a joint levy to be assessed by the United States Government and divided as between the Federal Government and the State, shall be disregarded by the legislative bodies of the American Commonwealths.

"It is maintained that a State should not be compelled in this fashion to become a party to a joint tax levy under penalty of losing a source of its revenue if it dissents. The purpose of the proposed law is ulterior. Never before in the history of the United States, except under stress of war conditions, has the Federal Government ever attempted to levy a property tax. If the present attempt is accomplished, the danger will be imminent of the Federal Government next dictating the entire taxing policies of all the States.

"We hold that the rights of the States, although often disregarded, still remain one of the fundamental principles of our democratic government, and that if we continue to surrender to the Federal Government every function which belongs to the States it will be only a question of time before centralization, with its attendant and inevitable autocracy, will submerge every remaining vestige of State sovereignty.

"The inheritance tax is a direct property tax, and to assume the authority to assess a joint levy, the Federal Government coming into the State and arbitrarily fixing the rate of assessment and sharing in the revenues, leaving to the State no election of choice, is, we hold, an unwarranted invasion, economically as well as politically, of the sacred principle of self-determination, which if permitted to go unchallenged will prove only the forerunner of even further abrogations of the prerogatives which the States have enjoyed without abridgement since the formation of the American Union upon the bedrock foundation of democracy: Therefore be it

"*Resolved*, That we, members of the Arkansas Legislature, in meeting assembled at Little Rock, Ark., this January 4, 1926, do respectively enter our protest against the passage of this provision by the Congress of the United States, and that a copy of this resolution be mailed to the two Senators and the Congressmen of this State after same has been submitted to the other members of the legislature not present, for their signature.

"J. B. Webster, vice president American Southern Trust Co., Little Rock; J. W. Hill, Arkansas Democrat; B. E. Tolley, representative Columbia County, Magnolia; A. B. Vaughan, Magnolia; W. H. McLaughlin, representative Lonoke County; Paul Grabiel, senator, Pulaski County, Little Rock, Ark.; W. D. Jackson, representative of labor, Little Rock, Ark.; Jos. Loeb, Little Rock, Ark.; E. Hope Brooks, representative Lee County, Ark.; T. O. Gray, representative Batesville, Ark.; Hugh D. Clark, representative Hempstead County, Hope, Ark.; W. S. McCord, Little Rock, Ark.; E. L. McHaney, Little Rock, Ark.; E. A. Rolfe, Forrest City, Ark.; John W. Hall, Widener, Ark.; Reece A. Caudle, Russellville, Ark.; M. B. Norfleet, sr., Forrest City, Ark.; Creed Caldwell, Pine Bluff, Ark.; Walter W. Raney, McCrory, Ark.; Ben B. Williamson, Mountain Home, Ark.; Sam D. Crawford, El Dorado, Ark.; Allen D. Sheeton, Lepanto, Ark.; Lester L. Gibson, Walnut Ridge, Ark.; J. L. Shaver, Wynne, Ark.; G. B. Oliver, jr., Corning, Ark ; Mrs. Sidney J.

Hunt, Pine Bluff, Ark.; Miss Erle Chambers, Little Rock, Ark.; E. W. Chaney, Little Rock, Ark.; Neill Bohlinger, Little Rock, Ark.; W. H. Abington, Beebe, Ark.; E. R. Collins, Gould, Ark.; Walter H. Riley, Pine Bluff, Ark.; J. C. Dawson, Conway, Ark.; Dolph Smith, Crawfordsville, Ark.; E. L. Page, Sheridan, Ark.; C. O. Wahlquist, Wynne, Ark.; D. B. Niven, jr., Pine Bluff, Ark.; Thos. A. Hill, Pine Bluff, Ark.; Peter R. Deisch, Helena, Ark.; S. B. Pete McCall, El Dorado, Ark.; J. A. Thornton, Mena, Ark."

(Whereupon at 12 m., the committee adjourned to meet at 10 o'clock a. m., Monday, January 11, 1926.)

REVENUE ACT OF 1926

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

TUESDAY, JANUARY 12, 1926

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

The committee met, pursuant to call, at 10 o'clock a. m., in room 312, Senate Office Building, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Watson, Reed of Pennsylvania, Ernst, Stanfield, Wadsworth, Shortridge, Simmons, Jones of New Mexico, Gerry, King, Harrison, Bayard, and George.

Present also: Senator Couzens, chairman of the Select Committee Investigating Bureau of Internal Revenue, and Mr. L. C. Manson, a counsel to that special committee.

The CHAIRMAN. If the committee will be in order we will begin our hearings. Senator Couzens, do you desire to be heard first, or do you want Mr. Manson to proceed?

Senator COUZENS. Perhaps I might just as well make a brief introductory statement, but Mr. Manson will make the report for the majority of the committee.

The CHAIRMAN. Senator Couzens, if you will just take a seat on this side of the table the committee will be glad to hear you.

STATEMENT OF HON. JAMES COUZENS, A SENATOR IN THE CONGRESS OF THE UNITED STATES FROM THE STATE OF MICHIGAN, AND CHAIRMAN OF THE SELECT COMMITTEE INVESTIGATING THE BUREAU OF INTERNAL REVENUE

Senator COUZENS. Mr. Chairman, and gentlemen of the committee, since we were before you a year ago to get our resolution extended to June 1, we have been proceeding with the matter given to our attention. Up until that time we obtained all the information we could get from the Bureau of Internal Revenue—that is, within the bureau—and called for considerable information in the way of cases and statistics to be studied and gone over during the time from June 1 until the convening of Congress.

During that time our committee sat and studied a great many cases, dealing primarily with amortization and discovery depletion and depletion of natural resources, and went over some audit cases but not a great many. We also went into some cases that came under the heading of special assessments.

All this summer recess Mr. Manson and his staff went into great detail, the result of which has been a quite voluminous report, which I hold in my hand. This report represents the first printed copy we have had, and it is the report of the committee. I thought to have copies of it here by the time your committee should meet, for all members of your committee, but they have not arrived. It is promised that they will be here very shortly.

So as not to cause a repetition of anything the staff may have to say I think it would be better for Mr. Manson to present to you gentlemen his views on the subject. I might explain that some of us are in accord and some of us are not in accord on all these matters; and it may be that those who are not in accord with Mr. Manson will have something to say at some other time, or even at this time. I would prefer that you should hear Mr. Manson now.

The CHAIRMAN. Your wishes, Senator Couzens, will be complied with. Mr. Manson, if you will take a chair right opposite the committee reporter we will be glad to hear you.

STATEMENT OF L. C. MANSON, ESQ., COUNSEL FOR THE SENATE SELECT COMMITTEE INVESTIGATING THE BUREAU OF INTERNAL REVENUE

The CHAIRMAN. Before you begin, Mr. Manson, let me ask Senator Couzens a question: Is the report which you are just submitting a unanimous report of the select committee or a majority report?

Senator COUZENS. No; Mr. Chairman, this is a majority report. Senator Ernst said he had not had an opportunity to read it through, and Senator Watson had only had opportunity to read about three-fourths of it, and they said until they had an opportunity to read it all the way through they would not want to sign it. I understand that the other members of the committee are in accord.

Senator ERNST. Have Senators King and Jones signed the report?

Senator COUZENS. Yes.

Senator ERNST. With or without reading it?

Senator KING. After reading it, I will answer.

Senator SHORTRIDGE. Is the report now in print?

Senator COUZENS. Yes; but this is the only copy our committee has been furnished with up to this moment. However, we were promised a supply for this committee by 10 o'clock, and I assume they will be here shortly.

The CHAIRMAN. We understand that a copy will be here to be furnished each member of the committee in a short time.

Senator COUZENS. Yes.

Mr. MANSON. We had expected to have them here this morning by the time your committee met.

Senator KING. The report is not complete. That is to say, there are two or three subjects yet to be dealt with.

Mr. MANSON. Yes; but I might explain that I do not expect to discuss anything here this morning that is not contained in the printed report.

The CHAIRMAN. You may proceed.

Mr. MANSON. We have some suggestions to make as to legislation on particular subjects which I will present to this committee. I

believe, however, that the consideration of these particular subjects will throw a great deal of light upon the general administrative methods employed in the Internal Revenue Bureau.

The CHAIRMAN. Have you those amendments prepared ready to submit to the committee?

Mr. MANSON. Yes.

The CHAIRMAN. And you will submit them during your analysis?

Mr. MANSON. Yes, sir. And they will show the necessity for some legislation of a more general character dealing with general administrative methods.

The first subject that I will bring before your committee is the matter of handling amortization claims. This subject was discussed to some extent when we were before your committee a year ago.

Senator REED of Pennsylvania. Those arise under both excess profits and the income tax law?

Mr. MANSON. Yes. Amortization is a deduction from the income, taken for the purpose of charging off excess capital charges due to war investments. It was a provision inserted in the law to permit a manufacturer who had made plant extensions for the purpose of manufacturing articles contributing to the prosecution of the war, to write off war loss arising out of such investment.

Senator REED of Pennsylvania. It is quite distinct from ordinary depreciation which all plants have?

Mr. MANSON. It is distinct in this? Ordinarily investment in plant would be returned tax free to the taxpayer as ordinary depreciation extending over the life of the plant. The amortization provision, in effect, permits the taxpayer extraordinary depreciation. It permits him to charge back as against income of the high war tax era that extraordinary depreciation which took place, representing, for instance, the difference between the war cost of his plant and what that plant is worth after the war, what it could be replaced for; and represented by the loss due to the investment in plant or equipment which is not useful for postwar business or operations.

Senator REED of Pennsylvania. Does it bother you if I should interrupt your statement to ask a question?

Mr. MANSON. Not at all.

Senator REED of Pennsylvania. Are these amortization charges still being deducted in present years, or does this apply particularly to the immediate postwar years?

Mr. MANSON. The deduction is taken from the income of the years 1918, 1919, 1920, and 1921. A large amount of the cases in which the deductions are taken are not closed cases.

Senator REED of Pennsylvania. I understand that, but it is not a future question in the sense that amortization deductions are going to be made in 1927 and 1928?

Mr. MANSON. Oh, no; that is not a future question in that sense, and on the other hand it is not water over the dam.

Senator REED of Pennsylvania. Because the cases are not yet closed?

Mr. MANSON. Yes; because the cases are not yet closed.

Some idea of the importance of the subject can be judged from the fact that the allowances passed up to April 30, 1925, by the engi-

neers amount to $596,984,000, and at that time there were still pending amortization claims which had not been acted on by the engineers amounting to $75,171,000. The staff of the investigating committee has examined all amortization claims passed by the engineers of the Bureau involving allowances of $500,000 or over. This represents in amount 72 per cent of all of the claims which have been passed by the engineers. So that we have covered a considerable percentage of the amount of amortization claims passed.

Senator KING. Are the investigations of the engineers sufficiently accurate and thorough to determine that the claims for amortization under $500,000 would aggregate only 28 per cent? The figure you gave previously was 72 per cent, I believe?

Mr. MANSON. Yes. Well, yes; that is true.

The CHAIRMAN. Necessarily so.

Mr. MANSON. The amortization claims, while they run large in amounts, are not great in number. All amortization claims exceeding $250,000 would not exceed 350 in number, but they will include 95 per cent of the amortization allowances made.

In our investigation of what we call Group 1 cases, that is, cases in which allowances exceeding $500,000 have been passed by the engineers, we find illegal allowances amounting to $210,665,360.40. Of these illegal allowances, allowances amounting to $139,537,691, are in cases which have not been finaly closed in the bureau.

Let me make myself clear on what we call a closed case. The amortization allowances are passed upon by engineers in the engineering division of the bureau. As a matter of law their determination is a mere recommendation to the commissioner. As a matter of fact, up to the present time, or up to a few months ago, an engineer's determination in an amortization case was in fact final because it was not revised by anybody, although as a matter of law the determination is not legally made until the tax is fixed. So when I say that in the cases involving $500,000 and over allowances of $139,500,000 can still be reconsidered I mean that while those allowances have been made by the engineers, the subject is still open for reconsideration by the commissioner, except for a provision in the law which limits the time within which the commission can redetermine amortization to March 3, 1924. You really have two statutes of limitation, as it were, in an amortization case. A statute of limitation applying to the determination of amortization, and a statute of limitation applying to the case generally.

Now the determination of these allowances in these cases up to the fall of 1925 was made without there being any published rule or ruling by the department for the information of either taxpayers or the engineers of the bureau, and in fact, without there being any written instructions or rulings, or any written rule or guide of any description for the guidance of the engineers of the bureau. The fact is that taking the whole subject generally, it can be said without exaggerating that each engineer has to a large extent been permitted to use his own judgment and discretion, and that there is no rule upon any question involving here $600,000,000 of allowances which has been followed consistently. There is no question involved in the whole subject where one set of engineers have not taken one position and another set of engineers have taken another. And

frequently the same engineers have altered their position from time to time and then gone back to their old positions on the same questions.

Senator SHORTRIDGE. Mr. Chairman, I will ask you to excuse me because I must attend another meeting. Before going I would like to ask this gentleman just one or two questions. I understood you to say that you had found that there were certain illegal findings by the bureau?

Mr. MANSON. Yes.

Senator SHORTRIDGE. Did your committee employ engineers to review or go over the work of the engineers employed by the Treasury Department?

Mr. MANSON. We did.

Senator SHORTRIDGE. And there is a difference of opinion as between your engineers and the engineers of the department?

Mr. MANSON. No, that is not where the question arises. There is no difference of opinion.

Senator SHORTRIDGE. How did you reach the conclusion that it was illegal?

Mr. MANSON. Very largely upon opinions of the Solicitor of the Bureau of Internal Revenue.

Senator SHORTRIDGE. What does he know about the facts?

Mr. MANSON. There is no question of fact; there is no dispute between our engineers and the bureau upon any questions of fact.

Senator SHORTRIDGE. I see.

Mr. MANSON. In fact, I want to say this, that throughout this entire investigation I think that there has been almost an entire absence of dispute between the representatives of the investigating committee and the representatives of the bureau on questions of fact.

Senator SHORTRIDGE. I see. Excuse me.

Senator REED of Pennsylvania. Will you give me again the amount of the illegal allowances in the aggregate? $210,000,000?

Mr. MANSON. $210,665,000.

Senator REED of Pennsylvania. Slightly more than one-third of the whole?

Mr. MANSON. No; that applies only in cases of $500,000 or over in which the total allowances amounted to $425,000,000.

Senator REED of Pennsylvania. About one-half of it?

Mr. MANSON. Yes, about half of it.

Senator REED of Pennsylvania. Now when you say that those were illegal, do you say that they were illegal in their entirety, or that claims aggregating that much contained partial or entire——

Mr. MANSON (interposing). I mean we have segregated from the claims the amounts that should not have been allowed, and the amounts that should not have been allowed amount to $210,000,000.

Senator REED of Pennsylvania. Then the $210,000,000 represents deductions that ought not to have been made?

Mr. MANSON. That is it.

The CHAIRMAN. That is not the amount of the tax; that is the amount of the amortization.

Mr. MANSON. That is the amount of the amortization allowances.

Senator SIMMONS. Well, that reduces the tax, does it not?

Mr. MANSON. Yes, that reduces the tax.

The CHAIRMAN. Yes.

Mr. MANSON. I can not make an estimate. In some of those cases the tax would be 80 per cent, and in some of them it would be 30 per cent.

Senator McLEAN. And there is $139,000,000 still in process of settlement?

Mr. MANSON. Now let me get this straight. There is $139,000,000 in these cases which have been passed by the engineers involving $500,000 or over. In addition to that there are some $79,000,000 of cases that have not been passed by the engineers. There are also 28 per cent of the allowances which we have not investigated.

The CHAIRMAN. Well, that is the amount less than the $500,000.

Mr. MANSON. Yes, that is the amount less than $500,000. We have investigated some cases under $500,000, but these figures are based on allowances of $500,000 or over.

Senator SIMMONS. Do you mean where the returns are under $500,000?

Mr. MANSON. No, where the amount of amortization allowed by the engineers exceeds $500,000.

Senator SIMMONS. I was not here when you commenced, and did not hear that part of it, that is why I asked.

Senator REED of Pennsylvania. May I ask one question more. In these cases, speaking generally, is the excessive allowance in your judgment due to mistakes of the bureau, or is it due to corruption?

Mr. MANSON. Oh, I do not maintain it is due to corruption. I do not maintain that, get that straight.

Senator REED of Pennsylvania. I am asking in all sincerity, because I am not familiar with the facts.

Mr. MANSON. Oh, no.

Senator REED of Pennsylvania. Have you found any evidence of corruption?

Mr. MANSON. Oh, no; I haven't any evidence of corruption. This matter of amortization is largely, in my opinion, a question of law. My criticism of the bureau and the method of handling this subject is that when the subject came before the bureau and they had enough cases before the bureau to know what was involved in it, that it was not taken up with the higher authorities and some principles laid down.

Senator CURTIS. Some rules.

Mr. MANSON. Some rules which can be uniformly applied to all cases where the same questions were raised.

Senator McLEAN. By "rules" you mean some interpretation of the law?

Mr. MANSON. Yes, yes. Now the determination of these allowances involves certain principles. Those principles have now been stated with a fair degree of definiteness by an opinion handed down by Mr. Gregg in October, 1925. There are some slight differences of opinion between Mr. Gregg and myself on that opinion, but very little. In other words, if they had defined the principles which were to be applied in these cases you would at least have a uniformity of treatment.

Now my criticism in regard to this subject is not confined to the fact that there has been a large amount of illegal allowances made. The fact is that taxpayers have not been uniformly treated

who had the same kind of cases, which involved the same questions. Now I do not care to go into the details of any particular cases, unless the committee wants me to do so, but I can show you where you have the same questions. For instance, we have this situation. It is manifest that one of the losses a taxpayer suffers who made a war investment is the reduced cost of replacement. He spent, we will say, $1,000,000 for a plant during the war period. After the war is over that plant is only worth $800,000 because he can build another one just like it for $800,000. He unquestionably has a loss there of $200,000. No disputing that. Now the bureau had in many cases——

The CHAIRMAN. Just a minute before you go on. I want to get that clear. Did you only allow the difference between the cost of building a plant before the war and after the war.

Mr. MANSON. Oh, no.

The CHAIRMAN. I wanted to get that clear. Because there are other decreases that ought to be allowed.

Mr. MANSON. Well, I have never questioned the allowances made for the difference between the war cost and the postwar cost of reproduction. I have never questioned any allowances made on facilities that have been discarded from use.

Senator KING. That is what you had in mind, Senator?

The CHAIRMAN. Yes.

Mr. MANSON. Yes, I have never questioned those. I have never questioned any allowances made upon facilities that have been sold. I have never questioned any allowances made on facilities which have been discarded and not sold. There are many instances where a taxpayer would have facilities for which he had no use, but there was a poor market. He was unable to sell them. If he had sold them immediately after the war he would have increased the loss. In such instances they are permitted to file a statement, I believe an affidavit, that they have discarded those facilities, and allowances have been made based upon the difference between the cost and the estimated salvage value of those facilities. I have never questioned any such allowance. The bulk of the allowances which we have questioned are allowances of this character: A taxpayer installes during the war facilities which were of the same kind as those in general use in his business. He merely increased the capacity of his regular business. After the war he installed more facilities of the same kind. In other words, after the war he increased his capacity again.

Senator KING. Using those facilities which he had created during the war?

Mr. MANSON. Yes; he retains them in use. And on top of retaining them in use he adds more. Take the Firestone Rubber Co., for instance. The Firestone Rubber Co. put in a large number of what they called massing machines, which is a machine that is used to grind the old and the new rubber up together. After the war they put in more of them. Now then, they were given an allowance in addition to the difference between the war cost and the cost of reproduction upon the theory that they did not have full use for the machines that they had installed during the war period, notwithstanding the fact that they had added more after the war.

Senator REED of Pennsylvania. And continued to use those that they had bought in the war?

Mr. MANSON. Yes, and continued to use those that they had bought in the war.

Senator KING. Up to full capacity?

Mr. MANSON. Well now, that depends upon how——

The CHAIRMAN. Were they used to full capacity during the war?

Mr. MANSON. That depends on how you——

Senator CURTIS. That would be immaterial anyhow.

Mr. MANSON. Well, that is the view that I took, that if the taxpayer after the war increases his capacity, that he is estopped from asserting that he is not getting the full use out of the capacity that he installed during the war.

Now the way those allowances have been made is this. In many cases they would take the peak month production during the war. In some cases the peak year during the war. The production of that period. Then they would take the average producton for 1921, 1922, and 1923 and they would compare the two. Now, if the average for the three years was 80 per cent of the peak year they would say that taxpayer had only 80 per cent use out of his facilities.

Now I would call attention to the fact that you can not even produce the production of one year with a capacity equal to that production. Now that may sound foolish, but I can demonstrate it. Supposing that you have a production of 120,000 tons of some material during the year. Now you have got to have a capacity of 10,000 tons a month to get 120,000 tons a year. But in order to get a production of 120,000 tons with a capacity of 10,000 tons a month you have got to run a full capacity 100 per cent of the time. If your monthly production for any month or during any period of months runs below 10,000 tons you can not get 120,000 tons production with 120,000 ton capacity.

Now there is no plant in existance that ever operated consistently to full capacity for a full year, excepting during the war period. And in the report I have illustrated that by taking the total production of steel in the United States from month to month, and if the steel companies of the United States had a capacity only equal to their average production for the three years 1921, 1922, and 1923 they would be entirely cut out of production during the period when prices are high. I have put in a diagram which compares production with prices, and have drawn a line across at the average production, and if you would cut off production at the average production you would be entirely cut out of the high prices.

Now I do not know whether the committee desires me to or not, but I can go on and cite instance after instance where one company has been allowed to take their postwar cost of reproduction and this loss due to lack of use, while other companies have been denied loss due to postwar cost of reproduction if they got the amortization based upon loss of use. Manifestly there is no erlation between the two of them. But some engineers got the idea into their head that they could not allow both, and some companies have received both, and some have only received one.

Senator REED of Pennsylvania. Mr Manson, that, as you stated, is plain favoritism of one over another?

Mr. MANSON. Yes.

Senator REED of Pennsylvania. Now I am impressed by the vast discretion which the law has entrusted to very poorly paid engineers and officials in cases that involve millions of dollars. You find nothing to indicate that favoritism was corrupt?

Mr. MANSON. No, I have never found anything in connection with an amortization case which indicated that any amortization engineer was———

Senator JONES of New Mexico. Senator Reed, I may state that all through the investigations of this committee there was no attempt made to discover corruption, or rather, to make that a feature. We were attempting to find out the facts, what occurred down there, regardless of how or why it had occurred.

Senator REED of Pennsylvania. You understand me, I am not taking any position for or against it, but in all our other wars there have been so many charges of that sort. Here was evidently a very great opportunity for it, and I am asking just as a matter of public interest whether you ran upon any traces of it, although I know that you were not making a particular search for that sort of thing.

Mr. MANSON. I am not a detective.

Senator REED of Pennsylvania. I know you are not.

Senator McLEAN. Well, Mr. Manson, was more than one engineer employed in any single case?

Mr. MANSON. Oh, yes, sometimes there would be two or three engineers employed in those cases.

Senator McLEAN. In a single case?

Mr. MANSON. In a single case. And of course where two engineers were working on a case one would be senior to the other one, and the senior engineer's judgment would prevail.

Senator REED of Pennsylvania. I am not asking this in any way in criticism of you or the committee.

Mr. MANSON. I am frank to say that I am not a detective, or I have not been hunting graft. I have been trying to get at how things have been done in the bureau for the purpose of seeing how I could suggest improvements.

Senator McLEAN. As a general practice was more than one engineer employed in an important case?

Mr MANSON. Yes, as a general practice that would be true.

Senator McLEAN. Two or more?

Mr. MANSON. Yes.

Senator ERNST. As a member of that committee I do not believe it would have been possible to have had graft to any great extent without it having been discovered by the thorough examination which the committee made, and they did not come across the slightest evidence of any fraud.

Mr. MANSON. No.

Senator KING. I think this perhaps might be said as a sort of an addendum to the statement of the Senator, and that will be perhaps discussed by Mr. Manson a little later. There were a great many employees in the department who, after getting evidence perhaps of improper assessments resigned and went out and solicited that case. And as soon as the attention of the department would have been called to the fact that the assessment was improper an abatement or a reduction would have been made. But many persons in the department have taken advantage of the secret knowledge which they

obtained, and gone out and profited by it. There have been a great many men who severed their relations with the department who got secret information and they have gone out and they have made very large profits as experts and advisers and as lawyers, and they are now appearing before the department.

Senator REED of Pennsylvania. Is there any regulation of the department to prevent that sort of thing?

The CHAIRMAN. I think that we did have one.

Senator KING. Not adequate.

The CHAIRMAN. Well, it may not have been adequate. I do not think so.

Mr. MANSON. I believe that I can make some suggestions that will at least reduce the opportunity for that sort of thing.

Senator MCLEAN. Just one more question. How are these engineers selected?

Mr. MANSON. Why, I suppose they are civil service employees. I know they are civil service employees, and I suppose they are selected through the regular course of the operation of the civil service law. I assume that.

Senator MCLEAN. Well, was your connection with the investigation such as to enable you to pass upon the qualifications of these engineers? Were they engineers of high character and standing as a general thing?

Mr. MANSON. I think that the most of the engineers that were employed in the Income Tax Unit are men of good ability, and so far as I know I have never seen anything to reflect on the honesty of them. I do not think they are outstanding men. You could not get outstanding men for the salaries they pay.

Senator CURTIS. The trouble is with most of them that they have had no outside experience, except the engineers.

Mr. MANSON. Well, now, for instance, the engineers and mining men, I think that most of them are a pretty good lot of engineers.

Senator MCLEAN. Well, then as I take it, the situation presented was such as would permit an honest difference of opinion as to the interpretation of the law?

Mr. MANSON. Well, yes. I will put it this way. I think that the engineers did as good as engineers can be expected to do in passing on questions of law.

Senator MCLEAN. Yes, that is the point that I make.

Mr. MANSON. Now if the principles, the legal principles which were to govern the engineeers had been laid down early in the game at a time when the question—I do not say before any cases came in, but mind you this provision was put in the 1918 act; the time within which amortization could be claimed, or a redetermination claimed, expired on the 3rd of March, 1924, and it was not until October, 1925, that the principles to be applied to the determination of amortization were ever laid down and published.

Senator WATSON. That was after your committee had investigated the subject?

Mr. MANSON. Oh, yes, we had been on the subject for a long time at that time.

Senator REED of Pennsylvania. What was the good of doing it then, Mr. Manson?

Mr. MANSON. Because there are still a large amount of cases—now I will explain just how that came about. I think it was in November or December of last year, something over a year ago——

Senator JONES of New Mexico. You mean November or December, 1924?

Mr. MANSON. November or December, 1924, that I presented the United States Steel case to the committee. In connection with the presentation of the United States Steel case we discussed the fundamental principles involved in the determination of any amortization allowance. There is nothing peculiar about the Steel case. In fact there is nothing peculiar about any of these large cases.

Senator REED of Pennsylvania. How much did the Steel case involve?

Mr. MANSON. The Steel case involved amortization allowances of about $55,000,000. The amount we took exception to was $27,000,000 in round numbers. The difference in tax was about $21,000,000. Now immediately after we presented the United States Steel case the commissioner ordered that case to be reconsidered, and the engineers formulated some sixteen questions which they submitted to the solicitor for an opinion. I do not know just when that opinion was handed down, but it was published in October of this year.

Senator COUZENS. Last year.

Mr. MANSON. Well, October, of 1925. It was published in October of 1925. That opinion contains the first comprehensive statement of the principles that ought to be applied in every amortization case.

Senator REED of Pennsylvania. And were they applied in the Steel case?

Mr. MANSON. Well, I assume they are being applied. The Steel case is being reconsidered.

Senator KING. But had they been applied in the determination prior to that time?

Mr. MANSON. If they were applied to the cases that we had examined it would result in the disallowance of $210,665,360.40.

Senator REED of Pennsylvania. Has the Steel case been redecided or is it in process now?

Mr. MANSON. It is in process of being redetermined at the present time.

The CHAIRMAN. Mr. Manson, let me finish the statement I started to make a little while ago. I was cut off. Did you find any case where an employee of the Bureau of Internal Revenue left the service of the United States and practiced before the department until after his absence from the Government service had been two years or more?

Mr. MANSON. Yes.

The CHAIRMAN. Well, then, it was in violation of law.

Senator KING. No.

Mr. MANSON. Well, I will cite you a specific case.

The CHAIRMAN. Well, that is on claims?

Mr. MANSON. Yes.

The CHAIRMAN. Well, now, have you found any where there is a claim of any employee of the department acting or appearing before the department before the two years has expired?

Mr. MANSON. Well, now, let us get this clear. I know of plenty of instances where employees have gone out of the department and have appeared before the department within two years.

The CHAIRMAN. On claims?

Mr. MANSON. Yes, on claims.

Senator KING. Yes.

Senator WATSON. When did we pass that law, Mr. Chairman?

The CHAIRMAN. It was in 1921, was it not, Mr. Gregg?

Mr. GREGG. Long before that; long standing.

The CHAIRMAN. Long before that?

Mr. MANSON. I will say this. I do not know of any case where an employee went out of the department and appeared upon a claim which was on file in the department when he was there, within two years.

The CHAIRMAN. Well of course, then the law would not touch him.

Mr. MANSON. No. But there are any number of cases—in fact it is the general practice for men to go out of the department and immediately begin to practice before the department.

Senator GEORGE. Mr. Manson, you say that prior to the Steel case there was no general interpretation given for the guidance of the engineers?

Mr. MANSON. No.

Senator GEORGE. Was there a practice obtaining in the department by which the engineers asked for special instructions applicable to particular cases in which they were concerned?

Mr. MANSON. No, there was not. And in fact, as I pointed out in the report, of which you will receive a copy, all of the power which the law vests in the commissioner, all of the discretion which is vested in the commissioner, is exercised by the heads of the divisions, and under the review system which was in force up to the time that we left the bureau—and I am not informed that it has been changed since——

Senator KING. That was in June of last year?

Mr. MANSON. Yes, that was in June. There was no review of the work done under any division head. In other words, a division is divided into sections. The work done in one section would be reviewed by a review section in the same division. Now the result of that is that any division head could fix up a case in any way he saw fit, and there is nothing in the procedure of the department which would have called that case to the attention of the commissioner or deputy commissioner, the solicitor or anybody else. The only way that case could have come to the attention of any superior officer would be by some subordinate going and making a protest or a complaint, and inasmuch as the rating of the subordinates and their opportunity for promotion and their liability to discharge depended upon their division heads, you can see that there is not much chance of a subordinate going over the head of his division chief to make a complaint.

Senator KING. Is it not a fact that several who did make such complaints were reprimanded?

Mr. MANSON. Yes. I do not know as it is necessary to go into it in detail, but I have cited instances in the report where chiefs of sections have protested against the determinations made by

the head of the division, and have been disciplined for doing so, and that is the only way whereby the determination of any case could ever come to the attention of the commissioner.

Now on this subject of amortization, however, there has been a most peculiar situation. There was the head of the section, whom you would assume would maintain some uniformity of ruling within his section on the same question in similar cases, but that uniformity has been absolutely absent.

The CHAIRMAN. Absolutely what?

Mr. MANSON. That uniformity, I say, has been absolutely absent. I have called attention in the report which you will get, to different important questions which affect nearly every amortization case, and have called attention to cases where the same question has been ruled upon both ways.

Now that is not due to a change of policy. For instance, in the Berwind White case there was a new power plant built during the war. After the war there was an additional power plant, that is, additional capacity installed in this new power plant. At the time that the amortization report was made, or at the time the investigation was made, the new power plant had a peak load connected of 95 per cent of its capacity, and the increase in the demand for current in the operation of the property was about 450 kilowatts a year, so that at the end of one year the entire capacity of that plant would be absorbed. They got amortization first on reduced cost of replacement There was no criticism of that. After they had given them amortization for reduced cost of replacement they then determined that the company only had about 50 per cent use of the plant, and they gave them amortization of 50 per cent of the residue after reducing the cost by the application of this method.

The company had three old power plants with aggregate capacity of 9,000 kilowats. The company had scrapped these old power plants and written them off their books. There was a fire kept under one boiler in the old power plant as a reserve, until the postwar plant was completed. When the postwar plant was completed, the old plants were scrapped.

Now the way they got this approximate 50 per cent amortization was by taking the capacity of the old abandoned plant that had been scrapped and written off of the books, and adding that to the war plant, and then taking the peak connected load, and of course you had there a capacity, including the scrapped plants, of about 19,000 kilowatts, and that gave them an amortization of approximately 50 per cent. Those figures are not exactly accurate, but that is approximately it.

Now then, the McKeesport Tin Plate Co. put in a boiler plant during the war. The McKeesport Tin Plate Co. sought to have the same sort of amortization method applied to their amortization claim as was applied to the Berwind White claim. The engineer that handled that case denied them the right to include their old boilers in the computation, and gave them an amortization allowance based upon the use being made of the new boilers. If the same method had been applied to the McKeesport case that was applied to the Berwind White case the McKeesport company would have got a million dollars more amortization than they received.

Senator REED of Pennsylvania. Was it the same engineer?

Mr. MANSON. No, no, it was not the same engineer.

Senator REED of Pennsylvania. The same division?

Mr. MANSON. The same division, the same section. Now the McKeesport Tin Plate Co. case was decided first; then the Berwind White case was decided. Now then, after the Berwind White case was decided the McKeesport people asked for a redetermination, and again sought to have the same method applied to their case that was applied to the Berwind White case, and they were denied it. Now that is just one inconsistency.

Senator REED of Pennsylvania. Now was there any reason assigned for that?

Mr. MANSON. Well, the reason assigned in the export is that the amortization was determined upon the basis of the use being made of their war facilities. Now I do not say that they cited the Berwind White case. In fact, the only way that a manufacturer who has a claim for amortization has of knowing what is being allowed to another manufacturer who is probably a competitor of his is by hiring a former employee of the bureau. There being no published rulings, and, as I say, no instructions even that would even permit a uniform treatment of similar questions by the engineers within the bureau, the only way that a manufacturer who had a claim had of knowing what somebody else had received, or what the practice of the bureau was, was by hiring one of the engineers that was employed in the bureau, or who had been employed in the bureau, and was familiar with it.

Senator COUZENS. Just at that point, Mr. Chairman, may I make a statement?

The CHAIRMAN. Yes.

Senator COUZENS. You raised the question of the two years under the statute whereby a former employee might not practice before the bureau. I desire to point out at this point that that statute does not apply and can not apply to an employee who knows of these irregular decisions going to an attorney for a corporation and telling him about it. He, himself, not having, of course, to appear before the bureau, and in fact the bureau may not even know that he has gone to the taxpayer's attorney or his auditors and pointed out these discrepancies. I wanted that to go into the record there because the statute does not cover the cases, as I see it, of getting information out of the bureau to the taxpayers.

The CHAIRMAN. The statute could not cover it, could it, Senator?

Senator COUZENS. I do not think it could; no. But that discloses, however, the inequities possible under the rule of unpublished rules and secrecy in the department.

Senator MCLEAN. Senator Couzens, were any such cases disclosed to the committee in your hearing?

Senator COUZENS. Oh, yes, yes.

Senator REED of Pennsylvania. Is not the principle of these decisions published in some way by these Treasury Department circulars?

Mr. MANSON. Well, in the first place, until a taxpayer is dissatisfied with a ruling of the bureau there is nothing in the procedure which provides for the publication of anything upon the subject. I might explain that procedure. Take this amortization situation.

Congress put this provision in the law. It is very general in its terms. I have cited the law in the report, and I do not think it is necessary to go into a detailed discussion of it here. All the regulations say is that the taxpayer shall be entitled to amortize the difference between the war cost and the postwar value expressed in terms of use. Now there is nothing in the regulation and nothing in any ruling published up to the time of a ruling of the solicitor in the J. I. Case Threshing Machine Co. case, which was published in November, 1924, which indicates how you were to arrive at value expressed in terms of use. What that means.

I submit that it is not a thing which is so obvious that anybody would know it. The J. I. Case Threshing Machine Co., case went before the solicitor. The solicitor handed down an opinion in that case condemning the determination. That opinion of the solicitor in that case was never followed, even in the case in which it was handed down. That opinion was handed down some months before it was published. But from November, 1924, until October, 1925, the only published ruling that there was on the subject had never been observed in the bureau even in the case in which it was made. So I submit that there is no way for a taxpayer to determine from reading any publication of the bureau of any description what principles were to be applied in the determination of his amortization claim.

Now, in October, 1925, Solicitor Gregg handed down a ruling which was constructive. The other ruling merely condemned the determination made. The principal point upon which it condemned it was that the taxpayer had made postwar additions to his capacity, and that that would estop him from claiming that he did not have the full use of the capacity created during the war.

In October, 1925, Mr. Gregg handed down a really constructive ruling that laid down the principles that are to be observed, and I think if that ruling had been handed down and observed two or three years before, that you would not have this situation to deal with now.

Now without going into any more detail here, it is my opinion that there are enough of these matters still in the bureau—as I say, they run to $139,000,000 in one class of cases; they probably run to $200,000,000 or over in the bureau now—that Congress should enact legislation which will require a uniform determination of the cases which can be still redetermined. I am not suggesting that you open the statute of limitations or anything of that sort. Now I maintain that that is no injustice to this paricular class as compared with those who have already gotten their amortization, because there has not been any uniformity in the amortization which has been heretofore allowed.

Now there is one other point that I believe deserves special attention.

Senator McLean. Before you get to that. You say that in some of these cases after a rule had been promulgated the allowances were still inconsistent?

Mr. Manson. Oh, yes.

Senator McLEAN. Well, was that due to the fact that these inconsistencies were based upon the reports of different engineers?

Mr. MANSON. No, it was due to the fact that Major De Lamater, who was the head of the amortization section at that time, did not believe that the solicitor was right, and he just did not follow the solicitor's opinion, although that opinion, as I say, was the only thing that a taxpayer would have for his guidance.

Senator WATSON. Is the major still in the department?

Mr. MANSON. No, he is not.

Senator REED of Pennsylvania. Mr. Manson, I am very much impressed with the distinction pointed out between the Berwind White case and the McKeesport Tin Plate Co. case. They are both in my State. They both did important war work. I can not think of any reason why one should be preferred over the other.

Mr. MANSON. I can not. I do not think it was any favoritism. The same thing that was done in the Berwind White case was done in many other cases. For instance, the United States Steel Co. was permitted to include equipment of various stages of age and condition with new equipment for the purpose of determining amortization, regardless of the particular use being made of the equipment installed during the war. Many other companies.

Senator REED of Pennsylvania. There was no reason why either the United States Steel or the Berwind White should get that privilege and the McKeesport Tin Plate Co. not get it?

Mr. MANSON. Oh, no; none that I know of.

Senator McLEAN. Your idea was that it was pride of opinion of the man that interpreted the law?

Mr. MANSON. That is it exactly.

Senator McLEAN. That is a pretty difficult thing to regulate by statute.

Mr. MANSON. Well, I say that statute can be made sufficiently clear so that the principles can be laid down. And my biggest criticism of the whole method is the fact that there has been no supervision over it. Now I can not find that the determination of a single amortization case ever came to the attention of the Commissioner of Internal Revenue until we threshed out this situation before this committee.

The CHAIRMAN. Mr. Manson, so that I will understand that Berwind White case, as compared with the other. If I remember your testimony, you said that they had installed 450 kilowatts postwar?

Mr. MANSON. No, I will just repeat that and you will get it straight.

The CHAIRMAN. Well, you repeat it and I will see whether I understand it as I understood it before.

Mr. MANSON. Prior to the war the Berwind White Co. had three power plants.

The CHAIRMAN. Three power plants.

Mr. MANSON. Of various ages. They aggregated 9,000 kilowatt capacity. During the war they built a new plant consisting of two 5,000 kilowatt units. Now the new plant was not completed during the war. It was not completed until 1920. They found that their old plants were so obsolete that they could not economically operate them even as a reserve. So in order to provide a reserve they began

in 1920 the installation of a third unit in the new plant in order to provide a reserve capacity.

The CHAIRMAN. And that was 450——

Mr. MANSON. No, that was 10,000 kilowatts.

The CHAIRMAN. Ten thousand kilowatts?

Mr. MANSON. Yes. But 5,000 would have taken care of them. They had an opportunity to buy a 10,000-kilowatt generator as cheap as they could buy a 5,000-kilowatt generator, and so they bought it. But their two installed units being each 5,000 generation they would need at least 5,000 in case one of them broke down, because their connected peak load was 9,500 kilowatts, and their increase in demand from year to year for current was about 450 kilowatts. So that at the end of another year their connected peak load would be equal to about the entire capacity of the war plant. That is, it would be within 50 kilowatts of it.

Now then, after the new plant was completed they closed the old plant down and kept fire under one boiler until the third unit was installed, and then they abandoned the old plant entirely.

The CHAIRMAN. How large was the third unit?

Mr. MANSON. The third unit was 10,000 kilowatts.

The CHAIRMAN. Ten thousand kilowatts?

Mr. MANSON. Yes.

The CHAIRMAN. And they abandoned how many kilowatts?

Mr. MANSON. They abandoned 9,000 kilowatts.

The CHAIRMAN. In other words, there were 1,000 kilowatts there that were more use than they had before that?

Mr. MANSON. Well, it was not in full use.

The CHAIRMAN. Well, in either case it was not in full use?

Mr. MANSON. No.

The CHAIRMAN. But that the only difference was a thousand kilowatts?

Mr. MANSON. Yes.

The CHAIRMAN. In the amount of prewar and postwar?

Mr. MANSON. Well, wait a minute.

The CHAIRMAN. Well, now, that is what I want to find out.

Mr. MANSON. Now, let us get this straight. Here before the war you have got 9,000-kilowatt capacity.

The CHAIRMAN. Yes.

Mr. MANSON. In 1920 when you bring in the new plant you have got a 19,000-kilowatt capacity.

The CHAIRMAN. That is the two that you put in during the war?

Mr. MANSON. No, that is the old plant and the new plant.

The CHAIRMAN. Well, that is the two five-thousands?

Mr. MANSON. Yes.

The CHAIRMAN. That is what I say.

Mr. MANSON. And the old.

The CHAIRMAN. And the old; that makes 19,000?

Mr. MANSON. Yes. Now, then, they abandoned the old plant and wrote it off the books.

The CHAIRMAN. That was 9,000?

Mr. MANSON. Yes.

The CHAIRMAN. That is 1,000 more than before.

Mr. MANSON. They had 1,000 capacity more than they had before the war.

The CHAIRMAN. That is what I say; that is what it was.

Mr. MANSON. Yes.

Senator JONES of New Mexico. And then after the war they added a new unit of 10,000.

Mr. MANSON. Yes.

The CHAIRMAN. Well, that, Senator, is what I want to find out: what the increase was.

Mr. MANSON. One thousand capacity.

The CHAIRMAN. That is what I thought.

Mr. MANSON. And 500 of that 1,000 had been absorbed at the time that this investigation was made by the engineers for the unit. They still had a margin of——

The CHAIRMAN. Now, in their amortization what were they allowed?

Mr. MANSON. Approximately 50 per cent.

The CHAIRMAN. That is, 50 per cent of the prewar or the postwar?

Mr. MANSON. No, they were first allowed all of the difference between the war cost and the postwar cost of reproduction.

The CHAIRMAN. Well, of course they were all allowed that. There is no dispute as to that.

Mr. MANSON. A good many of them were not.

The CHAIRMAN. Well, you believe that they ought to?

Mr. MANSON. Oh, yes; no question about that in my mind. Now, then, they amortized the 50 per cent of the residue left after reducing the value of postwar cost of reproduction.

The CHAIRMAN. Well, that would be 4,500, would it not? Fifty per cent?

Mr. MANSON. Well, expressed in kilowatts.

The CHAIRMAN. That is what I am expressing it in. I want to know just what they claimed and why they claimed it.

Mr. MANSON. Yes; expressed in kilowatts it is approximately that.

The CHAIRMAN. Four thousand five hundred.

Mr. MANSON. There was some fraction.

Senator REED of Pennsylvania. After Mr. Manson finishes I suppose you will ask Mr. Gregg for any comments that he has to make?

The CHAIRMAN. Yes.

Senator REED of Pennsylvania. And when you do I think Mr. Manson ought to be allowed to question Mr. Gregg to help us to get at the facts.

The CHAIRMAN. I think so too, and I will invite him to do it.

Senator WATSON. That is the way we did in the committee, and we had it full and free on both sides.

Senator REED of Pennsylvania. Do you not think it would be advisable and helpful to have Mr. Gregg question Mr. Manson now? I know neither will abuse the privilege.

Senator KING. I want to say this for the benefit of the other Senators, that in the hearings the Treasury Department was always represented, and their attorneys and solicitors were there, and whenever any statements were made or documents prepared copies were immediately handed to the Treasury Department, so that it was not an ex parte hearing at all. And the Treasury Department had full opportunity to cross examine, and to present documents, and make any replies, and, as Mr. Manson says, there was no purpose to incriminate

anybody. It was to try to get at the facts as to the method of administration, and if there were any flaws or defects in the administration of the law, that we might make suggestions for correction.

Senator REED of Pennsylvania. You see you gentlemen have a great advantage. We know nothing about the case, the rest of us.

Mr. MANSON. You understand that I am not attempting to make a full statement of all the cases.

Senator REED of Pennsylvania. Of course not.

Mr. MANSON. I do not think you would want me to consume your time to go over something that is in a printed report and there stated much more briefly than I could state it orally.

Senator REED of Pennsylvania. We want to get an outline from you of what we can do here.

Mr. MANSON. I am trying to give the high spots.

Senator KING. There are quite a number of cases where amortization was allowed where the facilities were constructed in part before we entered the war, and in answer to the contracts which they had with our allies, and they went along filling those contracts, and yet they were allowed amortization, notwithstanding the fact that they did not construct anything because of our entrance ino the war.

Senator REED of Pennsylvania. Well, our law did not contemplate that, did it?

Senator KING. They got those amortizations.

Mr. MANSON. I would like to present that situation.

The CHAIRMAN. May I ask Senator King just one question to clear that up?

Senator KING. Yes.

The CHAIRMAN. I know of a good many companies in the United States that were requested by our Government to build plants and prepare many, many months before we entered the war. In fact, a year, a year and a half, some of them, before we ever entered the war. Were those cases such as those that you refer to?

Senator KING. No, those that I have reference to were where they had contracts with the allies, and they built their plants because they were making enormous profits in selling powder and supplies to the allies.

Mr. MANSON. Well, I might present a clearer case than that.

Senator KING. That is the kind of a case that I have in mind.

The CHAIRMAN. If they were not requested by the Government——

Senator KING (interposing). Oh, no, they were not requested by the Government.

The CHAIRMAN. If they were not, I don't see why they should not be.

Senator KING. They should not have been.

Senator COUZENS. Do I understand the chairman to say that if they were not requested by the Government that amortization should be allowable without regard to the statute?

The CHAIRMAN. I think they ought to be taken into consideration.

Senator KING. Without regard to the law?

The CHAIRMAN. Under the law we have a right to allow them depreciation.

Senator COUZENS. Yes, but I understood the Senator as saying that because our Government asked to have manufacturers increase

their facilities for producing war materials that amortization was allowed even before it took effect under the law.

The CHAIRMAN. Well, depreciation could be allowed.

Senator COUZENS. I was not talking about depreciation. I was talking about amortization.

The CHAIRMAN. It might have been in that shape. I don't know.

Senator JONES of New Mexico. Those are decidedly distinct phases of the law.

Senator COUZENS. Yes.

Mr. MANSON. Depreciation is one thing, and an important thing, and amortization is another.

The CHAIRMAN. I am aware of that. But I was wondering whether any cases came out of that character where there was an undue depreciation?

Mr. MANSON. Well now, the law lays down very distinctly where the line is to be drawn. The law says that the amortization may be claimed upon facilities which were constructed, erected, installed or acquired for the production of articles contributing to the prosecution of the war with the German Government, and the acquisition must take place subsequent to the 6th of April, 1917. Now I have in mind this case. The National Aniline & Chemical Company. The National Aniline & Chemical Co. was a consolidation of seven going chemical plants. There was no new plant built and no additions to an old plant.

Senator WATSON. When was that consolidation made?

Mr. MANSON. The consolidation took place shortly after April, 1917.

Senator WATSON. Yes.

Mr. MANSON. Now here was a case where they consolidated under one company in exchange for the capital stock of seven going plants. There was no plant erected for war purposes at all. There was not a dollar spent for war purposes. Now they were allowed amortization on some $18,000,000, which was the appraised value at which those plants entered into the consolidation.

Mr. GREGG. May I ask a question, Mr. Manson?

Mr. MANSON. Yes.

Mr. GREGG. Is that a criticism of the department action in the case, or of the law itself?

Mr. MANSON. I believe the more I study that law that it is very clear that law was intended to encourage the construction of plants for the production of war necessities, and that it has no application whatever to the acquisition of a going plant or the mere change of title of a going plant. If the law was to be given the construction that it was given in the National Aniline & Chemical case you have this situation: I own a plant. I am an individual operator. All I do is to incorporate and I am entitled to amortization upon the plant that I already owned, because the corporation acquired the plant from me. There is no difference between that and the National Aniline & Chemical case. There the owners of seven plants turned their plants into the one company, and took the stock of the one company, and they were allowed amortization on the theory that the new company acquired war facilities.

Senator REED of Pennsylvania. That is the fault of the law, is it not?

Mr. MANSON. Well, I do not think the law was intended to cover any such cases.

Mr. GREGG. Well, does it, in your opinion, cover it?

Mr. MANSON. I do not think it does.

The CHAIRMAN. This is what the law says:

> * * * In case of buildings, machinery, equipment or other facilities constructed, erected, installed or acquired on or after April the 6th, 1917 * * *.

Mr. MANSON. Yes, for the production of articles contributing to the prosecution of the war with the German Government.

Senator KING. I do not think the law is broad enough to cover amortization in a case of that character.

Mr. MANSON. Now we have another situation which applies to most amortization claims, at least the large ones.

Senator MCLEAN. Before you get to that. Your idea is that that law would not apply regardless of the character of the production?

Mr. MANSON. That is it. I say that the character of the production has something to do with it.

Senator GEORGE. Mr. Chairman, may I suggest right there. It seems to me that the word "acquisition" there must be taken in connection with the other words. It falls in a general company of words. I do not see how——

Mr. MANSON (interposing). I have in mind a case where a company contracted for the construction of a ship prior to 1917 at the time when, if you remember, the shipping rates were tremendous. They contracted for the construction of this ship prior to 1917. The ship was in process of construction on the 6th of April, 1917. After the 6th of April, 1917, the old company organized a new company to which they transferred title to the ship, and because of that they got amortization.

Senator COUZENS. Just at this point, because of Senator Reed's interest in the McKeesport and the Berwind White cases, will you explain briefly the difference between the engineers' viewpoints in the Bethlehem Steel and the United States Steel cases?

Mr. MANSON. Well, in the Bethlehem Steel case they were not allowed amortization for the loss of use upon the same facilities upon which they were allowed amortization for reduced replacement cost. while the Steel Co. was.

Senator REED of Pennsylvania. By the same engineers?

Mr. MANSON. I don't know whether the same engineers.

Senator REED of Pennsylvania. In the same section?

Mr. MANSON. In the same section, yes. I do not know whether the same engineers examined the case. Is that so, Mr. Parker?

Mr. PARKER. I don't believe it was.

Senator REED of Pennsylvania. Was there any explanation, if you remember?

Mr. MANSON. No. It was just lack of supervision.

Senator COUZENS. There isn't possible any explanation, because of the lack of supervision. For instance, one engineer does not know what the other engineer does. For instance, the engineer that handled the Bethlehem Steel case does not know what the engineer that handled the United States Steel case did. So no one raises the question. The question should be raised by a supervising authority who saw that there was inequality in the settlements.

Senator McLEAN. In the same section, would the investigation come under the supervision of different men?

Mr. MANSON. Supposing we are engineers of the amortization section. The chief of the section assigns one case to you and one case to me. Those men write up their reports in accordance with their own judgment. Those reports come back to the chief of section for approval. The chief of the section has approved one determination on a question one way and another determination of the same question another way. I do not say on the same date, but in the same week.

Senator McLEAN. But these different decisions that he makes are due to the fact that the cases are brought to him from different sources, or perhaps not due to the fact, but the cases are brought to him from different sources, different investigators?

Mr. MANSON. Yes.

Senator KING. Well, he allocates the cases in just the way that was described by Mr. Manson, as if the chairman here would allocate one to you, one to me, one to Mr. Manson, and we make our reports and pass them back to the Chairman, or to the head of the division, and he O. K's them, and that is the end of it.

Senator JONES of New Mexico. He signs.

Senator REED of Pennsylvania. What explanation does the chief of the section make if they are inconsistent?

Mr. MANSON. I never heard him make any.

The CHAIRMAN. Mr. Gregg, do you know of any reason?

Mr. GREGG. The possibility of past inconsistencies in ruling in questions of this sort does exist. The point I wanted to bring out in this connection was that the opinion which is to be used in the closing of all cases now unclosed definitely settles the point that you have raised.

Mr. MANSON. Well, it settles a great many points. There is one point that it does not settle.

Senator KING. Let me ask you this question. You say the opinion which you gave on the 26th of October would definitely settle the questions which he has just discussed?

Mr. GREGG. Yes.

Mr. MANSON. There is one question it does not settle.

Senator SIMMONS. Mr. Manson, you said a little while ago that these rulings were in many instances in absolute disregard of the regulations?

Senator JONES of New Mexico. There was no regulation.

Mr. MANSON. I say the ruling itself was not observed. Put it that way.

Senator SIMMONS. Put it that way?

Mr. MANSON. Yes.

The CHAIRMAN. Well, you would prefer then to answer fully when you take the stand, Mr. Gregg?

Mr. GREGG. Yes.

Mr. MANSON. Now I know that Mr. Gregg has handed down an opinion. There has been as a matter of policy——

Senator COUZENS. Just before you start into that. Senator Wadsworth had a doubt in his mind whether the head of the section would not be able to see that these decisions were uniform.

Was it possible for the chief of the sections to go through the record in each of these cases to see that that existed?

Mr. MANSON. Oh, I think so. I think that the engineer's report will show the principles that he has applied, and there are review engineers in each engineering section who are supposed to review the determinations of the different engineers, but notwithstanding the reviewing engineers and the chief of the section and the chief of the engineering division there has been that same conflict of ruling.

I have given in this report a list of all these amortization cases over $500,000, and that list will show the cases where companies have been allowed both amortization for loss of use and amortization for reduced replacement cost. It will also show the cases where they have only been allowed amortization for reduced value in use. Now, that was not something that just slipped by. That was a matter of debate in the engineering division for a year. Hot controversy between engineers. But still nobody has settled the debate.

And now in Mr. Gregg's ruling on that particular point Mr. Gregg rules that wherever possible amortization for lack of use is to be determined by the use to which the war facility upon which amortization is claimed is actually put. In other words, they are to determine the amortization allowed on that facility regardless of other facilities wherever it is possible. But where it is not possible then they are to average all of the facilities in the plant.

Now, when they determine amortization on the particular facility they can grant amortization due to both reduced replacement cost and amortization due to the loss of use or to lowered use. But where they determine it on a general average, that there they can only grant the amortization due to reduced value in use, and can not grant the reduced replacement cost.

Now my judgment is that that opinion is unsound in that particular for the reason that there is no relationship between the two. If a manufacturer suffers a loss because of the reduced cost of the replacement of a plant he is entitled to that loss regardless of any other factor or element in the case. On the other hand I do not regard amortization of facilities retained in use for reduced use as sound in any particular. I have gone into the reasons for that fully, but I might summarize them in this way. A manufacturer has the opportunity under the law and under the regulations to discard any facility he does not need. He can make amortization based upon the difference between the cost and the salvage value. When a manufacturer who has the opportunity to discard facilities he does not need fails to discard but keeps such facilities in use he does so because he either has a present or future use for such facilities. Now you can not measure the value of a facility by the present use. Trying to measure value by use is like measuring weight by the foot. There is some relationship, but there are a lot of other factors to be considered.

Senator REED of Pennsylvania. And yet that is what the law requires them to try to do.

Mr. MANSON. No, it does not.

Senator REED of Pennsylvania. It does not?

Mr. MANSON. There isn't anything in the law to that effect.

Mr. GREGG. Before you leave that may I ask a question, Mr. Manson?

Mr. MANSON. Yes.

Mr. GREGG. How much of the total amortization which you estimate around $600,000,000 would be thrown out if you eliminated amortization based on reduced value in use?

Mr. MANSON. Well, inasmuch as I have not examined all of the cases I can not answer that question absolutely. Your amortization on reduced replacement cost in cases involving allowances of $425,000,000 amount to $187,583,000. Now if you can take the percentage there and apply it to all the cases, why you can get the answer to your question.

Mr. GREGG. It would mean that something around $350,000,000, of the total of $600,000,000 of amortization, would under your construction not be allowable?

Mr. MANSON. No, it would not be that percentage. It would be something about two hundred million.

Mr. GREGG. Well, your $180,000,000 is less than one-half of your $425,000,000.

Senator COUZENS. Yes, but there are other elements besides those two that enter into that total amortization.

Mr. GREGG. No, sir; those are the only two.

Mr. MANSON. Well, as I say, out of $425,000,000, your allowances for reduced value in use are $187,000,000.

Mr. GREGG. Oh, I thought you said reduced replacement cost?

Mr. MANSON. No; your allowance for reduced replacement cost is $65,712,000. Your allowance on facilities discarded and sold is $172,625,000. Your allowance on reduced value in use is $187,583,000.

Now to finish what I started to say. The manufacturer has his option to discard a facility and take his amortization. He does not exercise that option. Now the only reason he can have for retaining a thing in use is that he has got either a present or a future use for it. Supposing he has not a present use for it, but he knows that his old facilities are wearing out, and that in a year or two he is going to have to have new facilities, what is his loss? His loss is a loss of income on a premature investment; that is all. He suffers a loss of income because he has an investment that is not working, but he elects to retain that investment in his going plant, and his loss is a loss of income.

Senator KING. But they allow him the difference between the cost during the war and the postwar replacement?

Mr. MANSON. Yes.

Senator KING. So he gets that anyway?

Mr. MANSON. Yes. Now then, I maintain that when you have written down the cost of facilities that are retained in use to their postwar cost of replacement, that if the manufacturer elects to retain those facilities in use, by his election he estops himself from claiming that he did not need them. And that such loss as he may suffer is a loss of income, and not a total capital loss, as this method of determining amortization determines it to be.

Senator McLEAN. That is, notwithstanding the fact that his judgment may be poor, and in a year or two he may find he has no use for it?

Mr. MANSON. Well, of course you have a long period of time in which to make that election.

Senator McLEAN. How many years?

Mr. MANSON. Well, up to the 3d of March, 1924. And of course a manufacturer may go out here and buy at any time facilities that he does not need. His judgment may be poor. But I maintain that there is no formula that any engineer can work out as a substitute for a manufacturer's judgment as to what facilities he needs in his business; that that is a pure matter of judgment; and that the judgment of the taxpayer as to what facilities he needs in his business ought to be final upon that question.

Senator REED of Pennsylvania. Now you take these cartridge manufacturing machines up there in Bridgeport. Of course they were only worth scrap after the war.

Mr. MANSON. That is all.

Senator REED of Pennsylvania. But if they did not scrap them, if they simply kept them there and let them lie idle the chances are that they may lie there for 25 years before they are put in use.

Mr. MANSON. Well, all the manufacturer has got to do is to file an affidavit that he has discarded those facilities and does not want to sell them. He files an affidavit and takes his amortization down to salvage value. If at some future time he wants to bring them into use the regulations provide that he shall report that fact. Now, then, he discards them and he takes his amortization. If in the future he brings them back into use, he reports it as income. Now, in that way it is left absolutely to the option of the manufacturer to determine what he needs in his business, and what he does not need. And I say that when he has exercised that option, that that ought to be final as to what he needs, and scrap this whole involved method of trying to ascertain by an engineering formula a thing that can be only ascertained by the individual judgment of the individual manufacturer. And if that is done you have simplified this whole tax.

Now, for instance, under this method a manufacturer will get more amortization on facilities—that is, he will get more out of facilities that he retains in use; that is, he will get more loss than he will on those that he scraps.

Senator WATSON. Can you give us a concrete instance?

Mr. MANSON. I can give you an illustration of it that will apply to every case. Take this case. I have stated that just as briefly as it can be stated here, and I will just read you a short statement of it.

Another fundamental defect in this method of determining value in use is the fact that it completely ignores the salvage or scrap value of facilities retained in use.

Where a facility has a salvage or a scrap value, the loss, which the taxpayer may bear, can not exceed the difference between the cost and the salvage or scrap value.

The regulations provide that value in use shall not be less than salvage or scrap value. It is manifest that any facility, which is held in use by the taxpayer, must have a value to him in excess of

the salvage or scrap value. The salvage or scrap value can be realized by selling the facility, and if a facility is retained for use, it must be retained because it is considered to have greater value in use than the amount for which it can be sold.

When the per cent of value in use has been determined it is applied to the entire cost or cost of replacement to determine the value in use. Thus, amortization is allowed upon the residual scrap value to the same extent that it is allowed upon that portion of the cost which is recoverable by use.

Suppose that a taxpayer purchased 100 cars during the war at $1,500 per car. Assume that these cars can be replaced new after the war at $1,200 per car, but that used cars could be sold for $600 per car.

In other words, you pay $1,500 for the cars during the war. You can buy new cars after the war for $1,200, but you can get $600 for the old, used cars.

Due to reduced cost of replacement this taxpayer has sustained a loss of $300 per car or a loss of $30,000 on the 100 cars in use.

Now then, the value in use of those cars we will say is 75 per cent. In other words, he has use for only 75 cars.

The Income Tax Unit finds that these cars are 75 per cent in use. Now then, that 75 per cent is applied to the reduced cost of replacement. Now the reduced cost of replacement would be $120,000. Seventy-five per cent of that is $90,000.

Now if the cars are 75 per cent in use, the work can be done with 75 cars, and the taxpayer can sell the remaining 25 cars for $600 per car. After taking amortization for $60,000, the taxpayer sells 25 cars at $600 and receives $15,000, which now reduces his investment in cars to $75,000. He now has 75 cars in full use, capitalized for income tax purposes at $75,000, but the postwar cost of replacing 75 cars is $90,000.

Now that shows you there that he is permitted to write off from his books the scrap value of stuff that he has still got in use.

Senator WATSON. Did that actually happen in the case of cars?

Mr. MANSON. It happens in every case.

Senator WATSON. I mean, did that actually happen in the case of cars, or is that just a hypothetical illustration?

Mr. MANSON. That is just a hypothetical illustration, but it will happen in every case, because the scrap value is still there, whatever it may be, that is there. They apply the reduced percentage of use to the full cost instead of the difference between the scrap value and the full cost. The result is that they allow the amortization upon scrap.

Senator SIMMONS. I want to get it a little clearer in my mind. Your criticism goes to the lack of a consistent policy. And that is largely due to the fact that certain discretion is lodged in so many different people. Now I understand the law lodges the discretion with reference to the settlement of these controversies between the Government and the taxpayer absolutely in the Commissioner of Internal Revenue?

Mr. MANSON. Yes, sir.

Senator SIMMONS. The Internal Revenue Bureau is subdivided into divisions. And there is a head of each one of these divisions. The division is subdivided into sections, and each section has a head.

Now I understand you to say that these questions are decided, or they should have been decided by the head of the section based upon the report of his engineers?

Mr. MANSON. Yes. I think the amortization has mostly been decided by the engineers themselves.

Senator SIMMONS. Well, their decision requires the confirmation of the head of the section?

Mr. MANSON. Yes.

Senator SIMMONS. Now if there is any discretion exercised by him in making that decision under the law it is a discretion that the law invests in the Commissioner?

Mr. MANSON. Yes.

Senator SIMMONS. Now does the head of the section who is exercising this discretion which the law gives to the Commissioner, make any written statement of the facts which he finds, and of the interpretation of the law applicable to those facts in that case?

Mr. MANSON. The head of the section?

Senator SIMMONS. Yes: the head of the section.

Mr. MANSON. No.

Senator SIMMONS. What sort of a report is made in that section with reference to the determination of each individual case?

Mr. MANSON. The engineer makes a report. That report is approved or disapproved by the head of the section. That report then follows the case through until the final conclusion of the case. It is then filed away with the case.

Senator SIMMONS. The engineer then that makes the report finds the facts?

Mr. MANSON. Yes.

Senator SIMMONS. And does he attempt to apply the law?

Mr. MANSON. In amortization they have applied the law.

Senator SIMMONS. Engineers have applied the law?

Mr. MANSON. The engineers have applied the law.

Senator SIMMONS. But the application of the law to those facts has to be approved by the head of the section?

Mr. MANSON. Well, the whole report which shows how he has applied the law to the facts has to be approved by the head of the section.

Senator SIMMONS. Then the head of the section when he approves simply marks on it "approved"?

Mr. MANSON. That is all.

Senator SIMMONS. There is no statement made by him of the fact?

Mr. MANSON. No.

Senator SIMMONS. Or of his application of the law?

Mr. MANSON. No.

Senator SIMMONS. So that the only way in which the other sections may know of the principle upon which this particular section dealing with the case was decided is to go and get the reports of the engineers upon that particular case filed in that section?
section?

Mr. MANSON. Yes; that is it.

Senator SIMMONS. How many of these sections are there?

Mr. MANSON. Well now, in the engineering—I can see what you are driving at, Senator. In the engineering, each section has a spe-

cial line of duty. For instance, there was an amortization section that handled the amortization cases. Afterwards that was changed to what I think they called the appraisal section. Now their work is confined to that particular subject. There is no other section that is making amortization determinations. Now you will find. for instance, in another section in the engineering division will be the metals valuation secton. Their function is to value metal mines. There is no other section in the engineering division that values metal mines. Now when you get over in the audit divisions, however, there you have a different situation. There you have in the same division several sections that are passing upon the same question.

Senator McLEAN. Suppose you have a case that involves both depletion and amortization?

Mr. MANSON. Well, then there would be two sections that determine those two subjects. You will get an investigation and report on depletion from the metals section and a report on amortization from the amortization section.

Senator WATSON. Two different engineers?

Mr. MANSON. Yes.

Senator SIMMONS. You have got one section dealing with amortization, and that section, we will say, has half a dozen engineers allotted to the work of investigating these cases.

Mr. MANSON. Yes; maybe 25 or 30.

Senator SIMMONS. Now one set of engineers has no way of getting at the principle or the interpretation of the law or the manner of ascertaining the facts by one engineer in the same section except by reading over the reports of all the several engineers?

Mr. MANSON. Yes.

Senator SIMMONS. The head of the section there does not consolidate these cases so as to show the principle running through all of them?

Mr. MANSON. No. If you had that you would not have this situation.

Senator SIMMONS. You would not have this situation then. Now would not that situation be remedied if that report going to the head of the section had to be investigated by the head and he had to give the reasons upon which he based his approval? Stating the facts and his interpretation of the law in that particular case? Then would not that situation be helpful provided that approval on his part had been concurred in by the head of the division?

Mr. MANSON. I think it would, but I think that would be rather cumbersome. I think this. I believe that a proper procedure in the first instance would have been—for instance, here is the head of the amortization section. A lot of cases have come in presenting questions. I think he should have worked up—in fact, Major De Lamater did work up a Manual of Instructions to Engineers. But it was never followed. It is just a dead letter, and always has been. I do not know of a single case in which his Manual of Instructions to Engineers was followed.

Senator SIMMONS. What I am after is this, that the tax payers of this country are entitled to know what have been the decisions of the head of that section with reference to not only the individual case of the individual taxpayer whose case has been up, but with every other case.

Mr. MANSON. Well, Senator, I heartily agree with you on that.

Senator SIMMONS. Now there ought to be some provisions by which the head of that section should review all of these cases and reduce that to a permanent record so that the taxpayers of this country might know what interpretation he has placed upon the law with reference to all of these controversies that are raised.

Mr. MANSON. Yes. I believe that it is possible to reduce to writing the principles which are applied in the determination of any subject as fast as those principles come along for determination. In fact, I do not think that those principles ought to be predetermined before any taxpayers have a right to be heard on a thing, but I do think that preliminary instructions ought to be gotten out, which might be modified after a taxpayer has had a right to be heard. But I think that those preliminary instructions, even though they are subject to modification after hearing, ought to be published for the information of taxpayers in order that taxpayers may know at least what the Bureau proposes to do.

Senator SIMMONS. That is exactly the point.

Mr. MANSON. But you not only have no publication of the principles which have been applied in cases where taxpayers have been satisfied, but only about 15 per cent of the former rulings, the written rulings, the thing that has been crystallized into writing through taxpayers' appeals and so on, have ever been published. Out of all of the rulings made by the Solicitor and by the Committee on Appeals and Review and the Tax Advisory Board, which should be precedents, only 15½ per cent of them have been published.

Now the publication of that body of rulings would constitute precedents which in time would settle the law. In other words, you would have a growth of law on this subject that would be just like the growth of the common law, which has arisen through the publication of the decisions of the courts. Now this failure to publish the rulings in my opinion has many different injurious results. I think it increases the work of the bureau. When a taxpayer knows that a question has been settled he is not so inclined to insist upon it, to present it, that is, present a claim involving it, as he would be if he can not find anything in the decisions that are published that holds that he is not entitled to this thing, so he puts in a claim, and he sends his lawyer down here to urge it, and he spends a lot of time around here. Now that makes work for the bureau. It requires the employment of a large number of high-class men, and it costs a lot of money.

By reason of the failure to publish more than 15 per cent of the rulings it is absolutely necessary for a taxpayer who has a large tax claim to employ some former employee of the bureau. Notwithstanding the fact that I have been on this job for over a year, and have worked hard on it, and I think I know something about the bureau and the way that they do business, if I had a large tax claim I would employ a former employee of the bureau, not because I think that he could get any special favor that I could not get, not because I think that they would favor him as against me.

Senator WATSON. Not because he has a pull?

Mr. MANSON. No, I do not mean it in that sense at all. But I mean it in this sense, that he knows how they have done the things

that they do not publish, and because he knows that he is able to come in and ask for a measure of relief which is being handed out to everybody that claims it.

Now, another injustice that arises out of that is there are a large number of taxpayers that do not claim relief when they are clearly entitled to it; that is, they are clearly entitled to it if anybody is.

Then there is another thing about that. It increases the expense, and I think that the failure to publish the rulings is more responsible for the failure to close up the old cases and get rid of them than any other one thing.

Senator McLEAN. Right there, Mr. Manson. Have cases come to your attention where a taxpayer has not received the relief that he is entitled to?

Mr. MANSON. Oh, there are any number of cases right here in amortization, for instance, where taxpayers could not receive the relief that other taxpayers have.

Senator McLEAN. Well, where he has not received the relief that he is entitled to?

Mr. MANSON. Well, I am not prepared to say that, but I think that one taxpayer is entitled to anything that another one is. If it is right to give it to one it is right to give it to another.

Senator WATSON. Well, do you think then that the bureau on its own motion, on its own initiative, should grant this relief without any claim being filed?

Mr. MANSON. No; but I do believe this: I believe that if taxpayers knew what the administrative law on the subject is that they would claim what the other fellow is getting, and they would not be presenting claims and insisting upon claims and consuming their own time and money and the time and money of the Government fighting for claims that they know they can not get.

Senator JONES of New Mexico. Now, right in there. If those things were to be made known, would not that engineer and that chief of the section, when they signed the report which is to be published, see to it that it was in conformity with other rulings of the section?

Mr. MANSON. Oh, you would have to determine things according to principle if you are going to publish your determinations; there isn't any doubt about that.

The CHAIRMAN. Mr. Manson, in that connection I want to call attention to the fact that the Board of Tax Appeals was created, and one of the main reasons for its creation was that these should be published.

Mr. MANSON. Yes, but, mind you, you only get the decision of the Board of Tax Appeals in case a taxpayer is dissatisfied with a ruling of the bureau and goes up to the Board of Tax Appeals. You take this entire subject of amortization. There was not a single appeal except in the——

Senator SIMMONS. Because it was generally in favor of the taxpayer?

Mr. MANSON. Yes.

Senator SIMMONS. There was nobody to appeal?

Mr. MANSON. No; there was no appeal.

Senator SIMMONS. This head of this section there decides questions of just as great importance to the revenues of this Government as the Board of Tax Appeals decides?

Mr. MANSON. Oh, yes, sir.

Senator SIMMONS. And he decides them in a way where the Government can not appeal?

Mr. MANSON. Yes.

Senator SIMMONS. And only the taxpayer can appeal?

Mr. MANSON. Yes.

Senator SIMMONS. And, as you say, the taxpayer never appeals because the decisions are generally in his favor.

Mr. MANSON. Yes.

Senator SIMMONS. Now, if the head of that section was required to file an opinion setting forth his findings of fact and his application of the law to those facts in every case, and they were published and made public property, then every taxpayer would have in that report the advantage that he now gets by employing a man who has formerly been in the bureau, does he not?

Mr. MANSON. That is it.

Senator SIMMONS. Exactly. And the Government interests are protected, and the engineer, as Senator Jones has very properly stated, is restrained if he is disposed to exercise favoritism in making his report, or if he is disposed to disregard the regulations or the rulings in other cases.

Mr. MANSON. In my opinion it is morally certain that if men know their rulings are going to be published they are not going to make rulings which are manifestly inconsistent.

Senator SIMMONS. Yes, and for that reason I was utterly amazed when you made the statement a little while ago and said that these engineers practically decided the cases, and the heads just wrote on the word "Approved," and there was no record except in the report of the engineers of what they were doing in reference to these great questions involving millions of dollars of revenue to the Government.

Mr. MANSON. I have given a lot of thought to this particular matter that we are discussing, and my suggestion in regard to it is this. I do not believe that it ought to be necessary, for instance, to publish every case. That is not the point. But it ought to be necessary to publish every principle that is applied, and to publish every precedent that arises. Now my suggestion is this. That in order to enforce the publication of every principle I would have the law provide that no tax determination shall be considered final, notwithstanding the statute of limitations, unless the principles applied in such determination have been given publicity within 30 days after the case is determined. In other words, if the case is decided in accordance with general principles that have already been published, you do not need to publish anything in regard to it. But if you have modified an old principle, or if you have applied a new principle, or if you have reversed an old ruling you have got to publish it. And the mere publication of appellate rulings does not cover the situation at all, because in many cases the heads of divisions go ahead and close a case without anybody knowing how that case is closed. And it does not call for a formal rule.

The CHAIRMAN. Are you through with amortization?

Mr. MANSON. Yes, I am through with that.

The CHAIRMAN. We will then adjourn now until 2.30.

(Thereupon, at 11.55 o'clock a. m. an adjournment was taken until 2.30 o'clock p. m. the same day, Tuesday, January 12, 1926.)

AFTER RECESS

The committee reconvened at 2.30 o'clock p. m. Tuesday, January 12, 1926, pursuant to the taking of recess.

The CHAIRMAN. If the committee will come to order. Mr. Manson, you say you have a couple of more questions that you wish to discuss?

Mr. MANSON. Yes; there are a few that I would like to present here.

The CHAIRMAN. Very well.

STATEMENT OF L. C. MANSON—Continued

Mr. MANSON. The amortization statute is very specific to the effect that the facilities subject to amortization must have been acquired for a certain purpose stated in the act, namely, to produce articles contributing to the prosecution of the war with Germany. There are a large number of cases which are not included in the figures I have quoted here as illegal allowances, but in which the facilities amortized were contracted for prior to the 6th of April, 1917. Nearly every large amortization case contains items of that character. It certainly can not be said that a plant contracted for prior to the 6th of April, 1917, was acquired subsequent to that date for the purpose of a war that was not begun until that date.

Now Senator Smoot raised the question whether some of those manufacturers were not requested by the Government prior to our entrance into the war to make those plant additions. That is a factor that might have been considered in enacting this statute, but it was not. I call attention to that fact because while we were unable to segregate those amounts, we nevertheless considered allowances on facilities contracted for prior to the 6th of April, 1917, as being illegal allowances under this statute.

This statute, that is, the 1921 act, is very specific in that it requires as a condition to the right to amortization that claims be made therefor at the time of filing the return for 1918, 1919, 1920, or 1921. The fact has been called to my attention since the report was prepared, and therefore it is not in the committee report, that in a hurried examination of cases in which we happen to have access to the papers made yesterday, we located $43,608,916 of allowances made in cases where the allowance was not claimed at the time of making the returns.

Senator KING. Were those cases involving more than $500,000?

Mr. MANSON. Those were cases involving over $500,000 alone, and cases where we had the papers from which we could determine whether or not it was claimed.

Senator KING. And those were cases in which very large amortizations had been allowed?

Mr. MANSON. Well, here is the Firestone Tire Co., $2,016,000; the Hydraulic Steel Co., $1,154,000; the Anaconda Copper Co., $2,744,000; the Atlantic Coast Co., $1,136,000. Most of these allowances exceed a million dollars.

Senator KING. When were they allowed? Do you remember what year?

Mr. MANSON. Oh, they have been allowed within the last two or three years. A good many of them are open cases in which a reconsideration of the allowance can still be made if they desire to do so.

Senator KING. Those were the allowances not asked for then, as I understand it?

Mr. MANSON. Oh, yes; they were asked for, but they were not asked for at the time the return was filed.

Senator KING. That is what I mean.

Mr. MANSON. Now, I do not know the purpose of Congress in inserting that provision in the act, but Congress must have had some purpose in mind in inserting it in the act, and I am merely calling your attention to the fact that it has not been observed, that is all. I do not know what the purpose of it was.

Senator KING. That is, the act was specific that no deduction for an amortization shall be granted unless the claim is made at the time of the filing of the return?

Mr. MANSON. At the time of the filing of the return for the year. In other words, as I construe that language they can not allow amortization to be deducted from the income of 1918 unless there was at least some claim for amortization in the 1918 returns. I do not construe that to mean that they could not thereafter amend that claim and increase it if they wanted to, but thet statute is specific. And as I say, I do not know what the real purpose of the framers of that statute was in including that provision, but they did include it. And I am merely calling attention now to the fact that it has not been observed.

Senator SHORTRIDGE. Those claims have not been allowed yet, have they?

Mr. MANSON. Oh, yes, some of them are outlawed, allowed and outlawed. Some of them are still open.

Senator SHORTRIDGE. I understood you to say that some of them were still under consideration?

Mr. MANSON. No, they have been passed by the Amortization Section, all of them.

Senator SHORTRIDGE. Yes.

Mr. MANSON. And in the ordinary course of events would be allowed in the determination of tax.

Senator SHORTRIDGE. But have they been allowed? I do not understand you.

Mr. MANSON. Well, Senator, we get down now to a definition of what we mean by "allowed." When I say that they have been allowed I mean that the officers whose function it is to pass on these claims have allowed them. Now then technically no claim is allowed until the tax is finally fixed.

Senator SHORTRIDGE. Certainly.

Mr. MANSON. Actually however in the practice of the department when the claim upon which the engineer is to act has been passed upon

by that engineer it enters into the final computation the way he makes it.

Senator SHORTRIDGE. Now assuming that was improperly allowed, the Government has up to now, according to your opinion, no loss of revenue?

Mr. MANSON. It has not in all of these cases. In some cases it has.

Senator COUZENS. The Firestone.

Mr. MANSON. For instance, the Firestone Tire & Rubber Co. case, that was closed by 1312 agreement. That involves $2,016,000. The Hydraulic Steel Co. case involving $1,154,000 is open. The Anaconda Copper Co. case is open.

Senator WATSON. What do you mean by "1312 agreement?"

Mr. MANSON. Section 1312 of the statute authorized the Secretary to execute an agreement with the taxpayer that the tax will not be opened.

Senator WATSON. Yes; I remember.

Mr. MANSON. Yes.

Senator WATSON. Now, do I understand that after all these large allowances were made upon claims filed, that succeeding that, subsequent to that $40,000,000 were allowed on claims not filed?

Mr. MANSON. No; I say this, that in this list of cases that I have here which aggregate allowances of $43,608,916.01 the claims for amortization were not filed at the time of filing the return as the statute requires, but were filed at some subsequent time. Now, as I say, I do not know what object Congress had in that statute. I am merely calling attention to the fact that whatever object it had in including it, it has not been observed.

Senator SHORTRIDGE. Well, it is misleading to leave it right there, when you say it has been allowed and is settled, and then again you say it is still open.

Senator ERNST. Had not been finally disposed of.

Senator SHORTRIDGE. It is misleading.

Mr. MANSON. I do not mean to be misleading.

Senator SHORTRIDGE. I know you do not, but as I gather it you say that certain officers have allowed it, and in the ordinary course of proceedings it would pass along, but it would seem that they are still open, so I assume that the matter is still under consideration.

Mr. MANSON. Well, now, some of these cases, Senator, are still open, and some of them are outlawed.

Senator SHORTRIDGE. I see.

Mr. MANSON. Now, in the cases that are outlawed the allowances can not be reopened. In the cases that have not been outlawed the allowances can be reopened.

Senator SHORTRIDGE. Is it not a fact that none of the cases will be reopened, regardless of whether they are outlawed or not, unless they come within the recent ruling of Mr. Gregg?

Mr. MANSON. Well, I can not speak for the department in that regard.

Senator KING. Well, is there any indication that they will be reopened?

Mr. MANSON. These cases?

Senator KING. Yes; or any cases out of the multitude of amortization cases that you called attention to?

Mr. MANSON. Why, Mr. Gregg stated before our committee that some of them would be reconsidered.

Senator ERNST. Well, quite a number.

Senator KING. Well, I stated those that came within the provisions of his decision.

Senator ERNST. All of them come under that decision.

Senator KING. Oh, no; there are some that do not come under that decision.

Senator ERNST. I know, but you heard given in evidence before our committee that many of those cases are now being considered by the department and have not been finally disposed of. So to give any other impression would not be correct.

Senator KING. Well, I do not agree with you that there are many. There are some. I think the majority of the amortization cases have been closed.

Senator ERNST. Oh, thousands of them have been closed finally.

Senator KING. Yes.

Mr. MANSON. In number the vast majority have been closed. In amount I do not think they have, that is, finally closed.

Senator ERNST. In number but not amount.

Mr. MANSON. Yes; in number, but not amount.

Senator ERNST. Yes; that is my recollection.

Mr. MANSON. In the midst of my discussion of amortization, in the matter of publication of rulings the recess was taken. I started to say at the time the committee adjourned this morning that the statement had been made to our committee that unpublished rulings are not used as precedents, and that all rulings are published which are of general importance and in which it is possible to delete the facts. Now I do not question the good faith of the person who made the statement to our committee. I simply believe he is misinformed. And for this reason I have examined several hundred cases, practically all of them—that is, outside of the amortization cases—involve rulings of one sort or another either by the committee on appeal and review or the solicitor.

Out of all of the cases that I examined I only recall two published rulings being involved. All of the other rules were unpublished rules.

As to the matter of their use as precedents, I brought to the attention of the investigating committee a ruling by the committee on appeal and review in the General Motors case. That decision cited as authority seven unpublished rulings. And the decision stated that one of those unpublished rulings was cited as a precedent by the taxpayer.

Now, after the 1st of June, in connection with the examination of some cases, I wanted to get hold of two unpublished rulings, and requested the commissioner to furnish them, and I was denied the rulings upon the ground that they could not be furnished me without violating the law. And the question arises in my mind as to how a taxpayer can get hold of a ruling for the purpose of using it and citing it as a precedent in his brief that our committee's representative could not get hold of. Now I do not say that there is anything corrupt about that, but the answer, of course, is this, that he must have secured such a ruling through an employee of the

department who had access to it. That is, through some former employee who knew about it.

I intended to go further into the matter of unpublished rulings, because from my examination of this whole subject my opinion is that the most of the troubles of the Income Tax Unit, and the most of the just causes of complaint about the Income Tax Unit, are due to the failure to publish rulings.

I have had a good many lawyers come to me and tell me that they have advised clients that they did not have a claim. The client would consult them about a claim. They would advise him that he did not have a claim. That under the rulings of the department he was not entitled to anything. And I have been told then that some fellow would come along who was not a lawyer, that had no claim to consideration at all except that he had some inside information, who would advise this lawyer's client that he had a claim, and get the claim on a big contingent fee and prosecute it and get it. Well, now, the ordinary lawyer does not feel very good about being made a fool of in this way. And my own opinion is that the most important thing that can be done to improve——

Senator ERNST (interposing). Mr. Manson, do you go into that question of unpublished rulings here in this report?

Mr. MANSON. Yes. But I do want to impress this upon the committee, that I do think that the most important thing that can be done to improve the working of the whole system is the proper publication of rulings and precedents.

Now that is all I care to say on those two subjects. I have an amendment which I would like to present.

The CHAIRMAN. Will you put it into the record at this point?

Mr. MANSON. Yes.

(The amendment presented by Mr. Manson for the record is printed in full, as follows:)

Deductions for the amortization of facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government shall not be allowed in cases where the facility acquired was an operating plant when acquired by the taxpayer, in cases where the construction, erection, installation, or acquisition of the facility was contracted for prior to April 6, 1917, nor in cases in which such amortization was not claimed at the time of filing the return of the taxpayer for the years 1918, 1919, 1920, or 1921.

No deduction for the amortization of facilities retained in postwar use by the taxpayer in excess of the difference between the cost of such facility and the cost of replacing such facility on March 3, 1924, shall be allowed, unless such facility consists of a single indivisible unit, the size of which exceeds the taxpayer's postwar requirements, when future requirements are duly considered. In case the facility, upon which amortization is claimed, is a single indivisible unit, the size of which exceeds the taxpayer's postwar requirements, when future requirements are duly considered, the amortization allowable shall be the difference between the cost thereof and the March 23, 1924 cost of acquiring a facility of size adequate to meet the taxpayer's postwar requirements.

All allowances of deductions from the income of 1918, 1919, 1920 and/or 1921 for the amortization of war facilities heretofore made in cases in which a final determination of tax has not been made upon the approval of this act and in cases pending before the Board of Tax Appeals shall be redetermined in accordance with the provisions of this section.

Senator KING. Mr. Manson, have you and your assistants calculated the loss to the Government from these illegal amortization allowances?

Mr. MANSON. No, we have not. In order to do so it would be necessary to know the tax rate and investor's capital in every one of these cases, and in making our investigation of amortization we confined ourselves to that feature of the case. There are some cases where we know what would be, and some we do not.

Senator REED of Pennsylvania. I understood you to say this morning that it was not less than 30 per cent of the amount that you stated should have been allowed?

Mr. MANSON. It will run from 30 per cent to 80 per cent.

Senator KING. From 30 to 80?

Mr. MANSON. Yes, from 30 to 80.

Senator REED of Pennsylvania. So it was at least 30, and it might have been up toward 80?

Mr. MANSON. When I say that, the cases in which we know the rate, the lowest one that I know of was 30 per cent, and the highest was 80 per cent. The Steel case was 80 per cent. And there are other cases where the rate was as low as 30 per cent. I know of none where it was lower than 30 per cent. There may be, however, I do not know.

Senator REED of Pennsylvania. Are you going to postpone your discussion of oil depletion?

Mr. MANSON. Yes.

The CHAIRMAN. Mr. Gregg said he would prefer to have the question of amortization all together. He would like to follow it right now on this one point, and then Mr. Manson can take the stand again.

Senator REED of Pennsylvania. We will hear from Mr. Manson again on depletion?

The CHAIRMAN. Yes.

Senator KING. I think that is wise.

The CHAIRMAN. And it will be better for the record to have all of this discussion on this point in one place.

Very well, Mr. Manson, we will now ask Mr. Gregg to make a statement.

STATEMENT OF A. W. GREGG, SOLICITOR OF INTERNAL REVENUE

Mr. GREGG. In discussing amortization, I shall have to repeat necessarily, to some extent, the testimony given before this committee when the question of the extension of the investigating committee was up. I should like to read, at the start of the discussion, the statute under which we had to make some $600,000,000 of allowances. Here is the language of the act.

Senator REED of Pennsylvania. What is the act?

Mr. GREGG. I am reading from the 1921 act. The language is identical in the 1918 act. In reading it I would like to call attention to the fact that this is the language under which the department was called upon to make some $600,000,000 of amortization allowances.

The statute provides for the deduction—

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 war against the German Government, a reasonable allowance for the amortization of such parts of the cost of such facilities or vessels as had been borne by the taxpayer.

That is the statutory language under which we were called upon to make this $600,000,000 of allowances, under a statute which says, "a reasonable allowance for the amortization of war facilities."

In discussing any of these problems, such as amortization, I do not think we get the entire picture unless we go back and take into consideration the history of the legislation. This amortization section in the revenue act of 1918 which I have just read, as it passed the House, had a provision that the amortization deduction should not exceed 25 per cent of the net income of the taxpayer. Mr. Kitchin, who at that time was Chairman of the Ways and Means Committee, was very insistent upon this provision on the ground that unless some such limitation were put in the statute it placed too much discretion in the Commissioner of Internal Revenue and the Treasury officials. The bill as passed by the House contained that limitation. This committee removed the limitation, the Senate accepted the amendment, and the conference accepted it. The Congress removed the limitation with the desire to place unlimited discretion in the hands of the bureau in the computation of this allowance.

At the previous hearing of this committee on these same general subjects I quoted some of the debates on the floor of the Senate which illustrate and show very clearly that Congress realized the tremendous discretion that in this and similar provisions was being given to the administrative officials. Both Senator Simmons and Senator Smoot, on the floor of the Senate, in referring to this particular provision and to the special assessment provision stated that it placed more discretion in the administrative officers than any statute which had ever been enacted.

I call your attention to this for the purpose of showing that this general language was used advisedly with the thought that tremendous discretion would have to be exercised in administering the provision, and that that discretion was consciously and purposely given to the Treasury Department.

But the proposal is now, in 1926, to say by legislation how that discretion, which was purposely given in 1918, and which applies only to the years 1918, 1919, and 1920, should have been exercised.

Senator KING. Well, Mr. Gregg, you do not mean to say, do you, or convey the inference that where discretion is given and confidence reposed by the legislative branch of the Government in some executive branch that that absolves the executive department or branch from a very careful consideration of the powers granted, and absolves them from using due and reasonable care to see that the discretion is not abused or is not exercised in an arbitrary manner and to the disadvantage of the Government?

Mr. GREGG. No, sir, I do not think that the discretion has ever been abused. I do not think it had ever been contended that the discretion has been abused. As Mr. Manson stated this morning, in construing such an elastic statute, in allowing some $600,000,000 of claims under such a statute, there has been no evidence whatever of any fraud or any corruption or any irregularity in the settlement of any of those cases. What it all comes down to is a matter of difference of judgment, and I would like——

Senator REED of Pennsylvania. Mr. Gregg, may I interrupt you?

Mr. GREGG. Yes, sir.

Senator REED of Pennsylvania. I want to ask you the same question that I asked Mr. Manson. The temptation in cases of this magnitude with a force as poorly paid as yours in the bureau, is obvious to everybody. Have there been cases of corruption on the part of these engineers that made these estimates and men vested with authority under this section?

Mr. GREGG. So far as the bureau knows in the amortization sections there have been no such cases.

Senator REED of Pennsylvania. That is a very wonderful record, I am sure.

Mr. GREGG. The committee has made a very careful and exhaustive examination of all of the big cases——

Senator REED of Pennsylvania. Well, they have not been looking for crime particularly, I understand.

Mr. GREGG. True, sir; but in a careful examination of a case, any irregularity would in all probability show up. And of course we, the bureau, took every step to check and search for any irregularities.

Senator REED of Pennsylvania. Well, what is your opinion, regardless of what they have found, or what anybody has found? What is your opinion?

Mr. GREGG. I have never seen any evidence whatever of any fraud or any corruption or any influence in the settlement of these amortization cases. There have been cases of fraud within the bureau, of course. When the investigating committee started its hearing we submitted to the committee a list of the cases in which we had detected fraud and where we had prosecuted, and what had been the final termination of the matter. None of those involved amortization engineers. There is, so far as I know, and so far I have been able to find, no evidence whatever of any irregularity. And considering the amount of the claims, I repeat again, some $600,000,000 allowed under that indefinite statute, I think that is quite a tribute to the personnel of the section.

Senator JONES of New Mexico. Have you ever investigated this amortization section for the purpose of finding out whether or not there had been?

Mr. GREGG. We have, Senator Jones, some 75 investigators of the intelligence service who are at work on the entire unit all the time. No more on the amortization section than on any other section, but they are working in the entire unit continuously.

Senator KING. Do they examine the records?

Mr. GREGG. Yes, sir.

Senator KING. Do they have access to them?

Mr. GREGG. Oh, absolutely.

The CHAIRMAN. Mr. Gregg, at this point, and in connection with the House provision of the 25 per cent limitation on the net income on account of amortization, Senator Simmons's report was as follows:

> In the paragraph relating to amortization allowances, section 214 (a) 9 and section 234 (a) 8 it was feared that the language was not broad enough to include vessels devoted to war purposes, and provision has therefore been made for the amortization allowances in the case of vessels constructed or acquired on or after April 6, 1917, for the transportation of articles or men contributing to the prosecution of the present war. The clause limiting the amortization deduction to 25 per cent of the net income has been stricken out. The amount of amortization allowance to which a taxpayer may be

thoroughly entitled has little or no logical connection with the amount of his net income, and as a matter of fact the taxpayer is likely to need the full allowance most when his net income is small.

Mr. GREGG. One of the first questions which arose in construing this indefinite language of the statute was as to the nature of the amortization allowance and the cases which should be included within its provisions. I should like to stop just a minute to discuss that, because Mr. Manson went into it in some detail.

There are, under the regulations of the department, two classes of amortization cases, two types of amortization cases. One is where a taxpayer during the war period purchased factories, facilities, or machinery for the production of war materials at a cost which was materially in excess of the normal cost of the property but continues to use facilities to full capacity after the war. In that case his amortization is very simple of calculation. It is merely the difference between this excessive war cost and the normal postwar cost, and the provision allows him to write off that excess cost against his war income.

The other type of case is much more difficult. It is the case where the taxpayer during the war period acquired facilities to handle his war business which gave him a greater capacity than he would need in normal times. In that type of case the postwar replacement cost on his property may be just as great as the cost of it, but he does not need all of the facilities that he had acquired during the war in his normal postwar business.

The question arose right after the passage of the act as to whether allowance in such a case as last stated was proper. Mr. Manson took the position this morning at the hearing that no amortization allowance should ever have been made in that type of case.

Senator REED of Pennsylvania. No, as I understood him he took the position that it should not be allowed unless the taxpayer elected to discontinue the use of those facilities.

Mr. GREGG. To scrap them; yes, sir.

Senator REED of Pennsylvania. Or to leave them idle?

Mr. GREGG. Yes; or to discontinue entirely their use. Take a specific case. Suppose that prior to the war a taxpayer had 35 machines of a given type. During the war he acquired 35 more to take care of his war business. After the war he has a need, say, for 50 machines. His only choice is between scrapping 20 machines and continuing in use the entire 70.

Mr. MANSON. No; he can discard under the law.

Mr. GREGG. But he may instead of discarding or scrapping continue to use all of those facilities, since he has them on hand, and it is more economical to use all of them not at full capacity than it is for him to use the 50 at full capacity. He may elect to do that, and if he does, it seems to me quite obvious that he has a war loss which should be offset against his war income. He has that excess capacity as the result of his expansion during the war. I do not think that his election between using it in his business, although it gives him a capacity greater than he actually needs, and, on the other hand, scrapping it, should necessarily deprive him of amortization.

But, as I say, Mr. Manson says that that should deprive him of amortization, and that he figured roughly, I think, that some $250,000,000 had been improperly allowed on that basis. And I

may point out that his only disagreement with the bureau's action arises in cases where the computation is based on value in use rather than——

Senator REED of Pennsylvania. Well, Mr. Gregg, I do not understand that he took it quite as you state it, but rather that he found fault with the calculation of the loss of value of this unneeded capacity.

Mr. GREGG. He did that, Senator, but he also stated here, and it is contained in the report, that there was never any authority for any allowance for amortization based upon reduced value in use.

Senator ERNST. That is correct.

Mr. GREGG. Based upon a reduced value in use after the war?

Senator ERNST. That is correct.

Mr. GREGG. That is stated in the report, and Mr. Manson stated it this morning.

As I say, shortly after the 1918 act was passed the question as to whether amortization could be properly allowed in such cases was raised. Congress under the 1918 act created the Advisory Tax Board to pass on such questions as this. The board issued the regulations which were approved by the then commissioner and then Secretary of the Treasury in 1918, permitting amortization based upon a decreased value in use, in addition to amortization based upon a lower replacement cost after the war. In other words, Mr. Manson's criticism of such allowances is in effect a criticism of the construction of an indefinite statute which has been in force since 1919, and which has received the approval of three commissioners of internal revenue, three Secretaries of the Treasury, and the old Advisory Tax Board which was created for the purpose of framing these regulations and deciding these doubtful points. It seems to me that at this date to enter into any discussion of such a question on its merits is rather useless labor. It was decided in 1919, the ruling has been adhered to ever since, and the matter now is a dead issue.

Senator REED of Pensylvania. Now may I interrupt at this point?

Mr. GREGG. Yes, sir.

Senator REED of Pennsylvania. I was most impressed by what Mr. Manson said, not as to the injustice of the rule, but as to the inequality of its application, and if it is correct that it was applied as you stated, and as these three Secretaries have approved it, to the benefit of the Berwind-White Co. but was denied to the McKeesport Tin Plate Co., and was applied to the Steel Corporation and was denied to the Bethlehem Steel, that seems prima facie as a great injustice.

Mr. GREGG. Well, the point that I was taking up first, Senator, was the statement that any deduction based upon value in use was not permissible.

Senator REED of Pennsylvania. You are coming to these others, are you?

Mr. GREGG. I was coming to the details of the computation later.

Senator REED of Pennsylvania. All right.

Mr. GREGG. I wanted first to treat the general proposition of whether any allowance based on value in use is permissible.

Mr. MANSON. I might clear this thing up.

Senator ERNST. If you will pardon me just a minute. I would be glad to have you say just what you want to, but I would like to have Mr. Gregg proceed along the line he is proceeding, for I want to hear that view of it fully.

The CHAIRMAN. Senator, the committee thought that if Mr. Gregg wanted to ask Mr. Manson any questions he could do so, and we also extended that same privilege to Mr. Manson to ask any questions of Mr. Gregg that he wanted.

Senator ERNST. I just wanted him to finish this statement, and then have him ask whatever questions he wishes to ask. I have no objection whatever to his asking any question he wishes.

Mr. GREGG. I am glad to answer any questions.

Senator JONES of New Mexico. I think Mr. Manson's inquiry was right, because the point is right before us now, and if we clear it up now it will be better all around.

The CHAIRMAN. All right.

Mr. MANSON. The only thing that I wanted to say was, inasmuch as the discussion seems to be what my position is, that I can restate it in a very few words so as to remove any ground for discussing it. My position is that all of the amortization allowances which have been made have ignored vital factors of value, that is all of the amortization allowances for loss of use have ignored vital factors of value which even under Mr. Gregg's own opinion in the United States Steel case must be considered. I observed that when you had considered those, and if you did consider them, that you would not have anything left. In other words as to loss of value in use, if the taxpayer had elected to retain the facility in use when he had the privilege of discarding it. I think I stated that there was very little difference of opinion between myself and Mr. Gregg as to the principles that were to be applied here, and I wish to state now that if you will discard every difference there is between Mr. Gregg and myself, that under Mr. Gregg's own ruling these allowances are illegal.

Mr. GREGG. The differences, in the application of the formula in determining value in use I was coming to. The first point that I wanted to take up was Mr. Manson's statement this morning, and I do not think that I misunderstood him, that irrespective of how it was computed there was never any authority for allowing amortization on the basis of reduced value in use. The report on page 168 certainly so states in very clear language.

Mr. MANSON. Oh, I adhere to that.

Mr. GREGG. Well, that is what I was answering.

Mr. MANSON. My figures are not based on that theory though.

Mr. GREGG. That is what I was answering in showing the past history of and the reasons for this action.

Senator ERNST. If you are not through with that I want you to continue.

Mr. GREGG. That is all I wanted to say on that.

The CHAIRMAN. Let me see if I can understand your position a little more definitely. Let us take a case. Suppose the committee should now decide—not that it has been discussed a moment—but suppose they did decide that in future amortization, say, of an oil well, they should agree upon a certain percentage, and not to exceed

that percentage of amortization each year, what effect would your position as to value being the vital question have upon such legislation?

Mr. MANSON. Well, are you talking about amortization or depletion?

The CHAIRMAN. Well, I can bring that up now. I wanted first to ask you another question, but I might as well bring it up now.

Mr. MANSON. On depletion, do you mean?

The CHAIRMAN. Yes; on depletion.

Mr. MANSON. Let me understand you——

The CHAIRMAN. The value, you say, is the vital part of the question here of allowance for amortization?

Mr. MANSON. Yes.

The CHAIRMAN. Does it apply now as to depletion the same way in your opinion?

Mr. MANSON. Oh, no; we have got two different questions entirely.

The CHAIRMAN. I know we have, but I ask you whether in your opinion it did apply in the same way with depletion as with amortization?

Mr. MANSON. No.

The CHAIRMAN. I want to know because this question will come up later.

Mr. MANSON. No; I can not see any relation between the two.

Senator SHORTRIDGE. Mr. Gregg, your observations of a moment ago were addressed to the law as you construe it?

Mr. GREGG. Yes.

Senator SHORTRIDGE. Now you are proceeding to take up specific cases, is that right, as to whether you applied the law as you interpreted it?

Mr. GREGG. The first criticism of Mr. Manson that I was answering was with reference to the allowance of any amortization on the basis of value in use, and I wanted to point out in that connection that it had been done consistently by regulations since 1919, that it affected only the war years, and that it seems to me that it is too late now to go back and tell the department how it should have exercised discretion in that respect, which was unlimitedly and advisedly given to it in the 1918 act.

Now, coming to the matter of the application of this law——

Senator WATSON. Let me ask you one question, please, Mr. Gregg. I do not remember whether you were asked this question in the committee. As you look over that particular phase of amortization now do you think that mistakes were made in those allowances?

Mr. GREGG. Mistakes were made in some allowances; yes, sir.

Senator WATSON. In this particular phase, value in use?

Mr. GREGG. Not on the general proposition that amortization is permissible on the basis of a reduced value in use. I think that our present judgment in the application of that formula for determining postwar value in use to particular cases would be better than the judgment which was exercised some five or six years ago without the experience and knowledge which we have gained since then by working on these cases.

Senator REED of Pennsylvania. But you do not think that the rule that was established by these three successive administrations of the Treasury under this general statute was a wrong rule?

Mr. GREGG. No, sir; that is why, to illustrate why I thought it was not a wrong rule, I gave the example of the machines.

Senator REED of Pennsylvania. Now, Mr. Gregg, was that rule criticised during the early part of its life?

Mr. GREGG. I have been in the Treasury, Senator Reed, since 1920. I have never heard any criticism of that general rule whatever. The rule has stood since then to my knowledge, to my personal knowledge, and I know from the regulations, since 1919, and I have never heard any criticism about it.

Senator JONES of New Mexico. Nobody knew what it was, did they?

Senator REED of Pennsylvania. Was the rule public?

Mr. GREGG. It is a part of the public regulations; yes, sir.

Senator REED of Pennsylvania. Since when has it been public?

Mr. GREGG. Since 1919. I can give you the exact date.

Senator REED of Pennsylvania. Did every taxpayer know that it was there? Of course I know it was there for them to see, but——

Mr. GREGG. Well, it was there. There are hundreds of thousands of copies of the regulations that have been distributed. The first was in a Treasury decision issued April 16, 1919, signed by Daniel C. Roper, commissioner, and Carter Glass, Secretary of the Treasury.

Senator ERNST. Will you please give the date?

Mr. GREGG. April 16, 1919.

Senator KING. Do you say that that rule which you say was promulgated then in the regulations is the same rule which you announced in your opinion?

Mr. GREGG. The general proposition is the same. The details of working out the postwar value in use are not covered in the regulations, and differences of opinion can certainly arise on it.

Senator KING. Well, the regulation merely prescribes, does it not, that there shall be deduction for the value in use?

Mr. GREGG. Yes, sir, and that is what I was pointing out. I was justifying that regulation. Now I am coming to the matter of the details of its application.

Senator KING. Have you got that 1919 regulation which you say was promulgated then?

Mr. GREGG. I haven't it with me. It is verbatim in the existing regulations.

Senator ERNST. We had it in our hearings.

Mr. MANSON. There is one sentence there which says that the value shall be determined in terms of use.

Mr. GREGG. In terms of present use.

Mr. MANSON. Yes.

Mr. GREGG. That was the general principle that I was justifying. Now in the application of that general principle to specific cases of course most difficult questions are bound to arise. I have hastily run through the report to see the points which have been criticised most in the application of the whole amortization section, and I would just like very briefly to run over those to show you the difficulty, to show you that there are certainly two sides to the questions in dispute.

The first one that I should like to refer to is the case of the National Aniline & Chemical Co., which counsel for the investigating committee referred to this morning, where after April 6, 1917, there was a consolidation of several going concerns. The new company claimed that it acquired the assets of the old corporations which were dissolved in that consolidation after April 6, 1917, and therefore was entitled to amortization. To show you how close that question is—and I do not mean to say this critically at all—when I asked Mr. Manson this morning whether he thought his criticism was one of the law or of the action of the Bureau he said he thought it was one of the action of the Bureau—that we had misconstrued the law. Not critically, but as indicative of how close these questions are I would like to point out that about five days ago when the same question was up in the investigating committee Mr. Manson was of the opinion that it was a criticism of the law, and that it was not our fault in construing it.

I think that we properly construed the law, but it is admittedly a close question as to whether that was such an acquisition as entitled the new company to amortization on the theory that the assets were acquired after April 6, 1917.

Senator Reed of Pennsylvania. On the general principle that a tax law is to be construed most favorably toward the taxpayer it seems to me that the word "acquisition" in the law would cover such a case, although of course Congress never dreamed of such a case when it passed it.

Mr. Gregg. Congress unquestionably had no such case in mind, but analyzing the transaction and applying the statute to it, what happened was that this new company, which is an entirely separate and distinct entity from the old companies which were dissolved, this new company, the taxpayer, acquired the properties after April 6, 1917, and used them for the production of articles contributing to the prosecution of the war. I should say that our construction of the statute in that case was clearly correct, but I pointed it out to show the closeness of the question.

Senator Watson. I understood that they did not furnish any war material.

Mr. Gregg. Oh, yes, the National Aniline & Chemical Co. furnished war material.

Mr. Manson. I did not say that they did not furnish any war material, Senator.

Senator Watson. Oh, I understood you to say that this morning.

Mr. Gregg. Now another point that arose in which the action of the bureau is criticised in the report——

Senator Jones of New Mexico. Now on that basis was amortization allowed in that National Aniline & Chemical Co. case? Where it was a combination of going concerns?

Mr. Gregg. It was allowed on the basis of the value at the date of the consolidation.

Senator Reed of Pennsylvania. The question of value in use does not arise in that case at all.

Mr. Gregg. Mr. Manson made no criticism, as I understood, of the computation. His criticism was of the allowance at all.

Senator SHORTRIDGE. What case was that?

Senator JONES of New Mexico. The National Aniline & Chemical Co. case.

Senator REED of Pennsylvania. They allowed the difference between cost and replacement.

Mr. MANSON. What they did in that case was this: there were seven plants consolidated. The seven plants were owned by three different corporations. The three different corporations had a committee appraise the different plants for the purpose of consolidation. Now after the war was over they desired to—the truth of the matter was there were more plants competing in that business than the business would stand for, and they wanted to scrap.

Senator JONES of New Mexico. Was that the case at the time of the consolidation?

Mr. MANSON. Why, I assume that was the purpose of the consolidation. Of course during the war there was an abnormal demand for their product, but as soon as the war was over they abandoned all of these plants, except one in Buffalo, and consolidated the entire business in Buffalo. Thus eliminating a lot of competing plants. Now at the time they took their amortization they took the difference between the value that had been placed upon the going businesses of these plants—

Senator KING. Paid for in stock.

Mr. MANSON. Paid for in stock, and the scrap value of the plants. Now one criticism we had of that case was that inasmuch as those plants had been appraised as going concerns when they went into the consolidation, that they should have been appraised as going concerns when they were abandoned.

Senator REED of Pennsylvania. In other words, there was an element of value which was carried into the Buffalo plant in the good will of those that were scrapped?

Mr. MANSON. Yes. The entire good will of these plants was amortized, that is about the size of it.

Senator KING. You have narrowed it more than I am willing to. I think that where going concerns form a corporation and transfer their assets of the corporations and close some of them up, that they are not entitled to amortization at all, that they do not come within the letter or the spirit of the law. I think that it is a fraud upon the Government when they claim amortization.

Senator REED of Pennsylvania. It is certainly within the letter of the law.

Senator KING. I do not think so. I do not think that that is an acquisition which is contemplated.

Mr. GREGG. I would like to answer the criticisms of that case one at a time. The first one, that no amortization was allowable, it seems to me is answered by the letter of the law which specifies acquisitions as well as new property built up, property acquired at the inflated cost as well as property which you have actually built. If Congress desires to exclude properties which had been in existence prior to the war there was certainly no reason for using the word "acquisition" in the statute.

The second point as to the amount of the allowances; in determining the value at the time of the organization, we used the appraisals

which were made at the time and on which an $18,000,000 transaction went through between the different parties interested, dealing at arm's length. That I should say is sufficient justification for the value which we set up at the time of the organization.

The CHAIRMAN. Well, would the values have been different if you had taken values before the consolidation, or as you took them?

Mr. GREGG. Well, we have to take them at the time of the consolidation.

The CHAIRMAN. Under the law?

Mr. GREGG. Yes, sir.

The CHAIRMAN. Of course you think that is lawfully and technically correct. What about the moral side of it?

Mr. GREGG. Well, the only peculiarity about the case is that they acquired it for stock. Certainly if they had gone out and paid the $18,000,000 in cash for the property there is no question about it. I do not think the situation is changed when they acquire it for stock rather than cash.

Mr. MANSON. When they abandoned the plants they did not abandon the good-will and the going business of the seven plants which they acquired. All they abandoned was the physical plants.

Mr. GREGG. Certainly, the good will was treated separately. The physical properties were appraised at the date of the organization. The amortization was based on the basis of the physical properties. The item of good will was a separate and distinct item.

Senator REED of Pennsylvania. Was it separately appraised at the time of consolidation?

Mr. GREGG. I assume so. I do not know. The value at the date of the consolidation of the physical property was what was used as the basis of the amortization. I have not checked over the appraisals. As a matter of fact this case was not referred to in the hearings before the committee. It was one of the cases that was worked on during the summer, and the first time I heard of the case was when it was brought up in connection with the report.

Senator KING. As I understand you then, Mr. Gregg, in a case of this kind, of the Aniline Dye Co.'s, they would be allowed amortization. If I were running two or three plants at the same time, of the same character, and I did not form a new corporation, if I had the old corporations and furnished war material I would not be allowed any amortization for the reason that I had not acquired it?

Mr. GREGG. That is true.

Senator KING. It is manifestly such an injustice there that it would have compelled everybody to sell his property or form a corporation, fraudulent corporation, or a paper corporation in order to get amortization. And the man who forms the paper corporation would get amortization, and the man who honestly conducted his business right along would not get it.

Senator REED of Pennsylvania. Exactly, and I think the fault lies with us in passing a law so loose.

Senator KING. I do not think the statute meant that.

Mr. GREGG. May I point out just along that line, that the new company could get, after reorganization, amortization, whereas if

the old company had continued in existence it could not. But, showing the fault with the law, I would like to point out that up until the time of the 1924 act a corporation could by reorganizing get its depletion on the basis of the excess value over cost to it. An exactly comparable situation. Merely by going through a reorganization it could improve its tax status. That was corrected for the first time in the 1924 act.

Senator McLEAN. Suppose there was no combination, but one single company should purchase the stock of other competing companies and control them, would they be entitled to it?

Mr. GREGG. No, sir; because it was not an acquisition of the assets. It was only an acquisition of the stock, recognizing the separate corporate entities.

The CHAIRMAN. During the war period did they use all these plants?

Mr. GREGG. Yes, sir.

The CHAIRMAN. During the war period?

Mr. GREGG. Yes.

Senator JONES of New Mexico. They were all being used during the war and before the war, as I understand.

The CHAIRMAN. I thought if they were not using them before the war it would be worse than ever.

Senator KING. They did not build any new plants.

Senator REED of Pennsylvania. We are all delaying Mr. Gregg, I know, but we might as well finish with this. You can not possibly say that that was a fraudulent consolidation made to take advantage of this provision of the law, because the consolidation took place at least a year before the law was passed.

Mr. GREGG. The law was not passed until 1919, Senator.

Senator REED of Pennsylvania. And the consolidation was made in 1917.

Senator JONES of New Mexico. I do not think it can be said here that this was a purchase of those war facilities because of the war. These facilities were all in operation before the purchase, and they were turning out just as much stuff before the purchase as afterwards. So it seems to me that it can not be said that they bought up these things for the purpose of increasing war facilities.

Senator REED of Pennsylvania. That is not what the act says.

Senator JONES of New Mexico. I think it is.

Senator KING. It is for war facilities.

Senator JONES of New Mexico. That is what it means.

Mr. GREGG. It says assets acquired for the production of articles.

Senator JONES of New Mexico. For the production. But they were already producing.

Senator McLEAN. The war was on.

Mr. GREGG. Of course if Congress meant to exclude properties which before the war were already producing they should not have used in the statute the word "acquired." They should have used the remainder of the statute and left out the word "acquired."

Mr. MANSON. How could you get new machinery then if you did not use the word "acquire"?

Mr. GREGG. Well, that would be another case which would be thrown out, if you left out the word "acquired." But at the same

time, "acquired" fits the case of the National Aniline & Chemical Co. just as well as it does the case of purchased machinery.

Senator COUZENS. I think that this whole discussion indicates the value of investigating the Internal Revenue Bureau and the application of the laws of Congress. I contend that if Congress had investigated the application of a case like the Aniline Dye Co. they would have corrected it long ago. It is obvious it was not the intention that the acquisition of these plants by the Dye Co. meant that it was to be amortized, and the fact that it has gone on, as the Solicitor has said, and properly so, without any modification by Congress since 1918 to 1924 makes it a self-evident fact that the application of these laws ought to be known by Congress, and they were not known by Congress until this investigation took place.

The CHAIRMAN. Was not the regulation before it, Senator?

Senator COUZENS. The regulation says nothing about that.

Senator KING. No one could tell from a regulation the abuse of the statute, as evidenced by the case we are now discussing.

The CHAIRMAN. Well, if it had been abused it would have to be contrary to law and contrary to the regulations, and if they issued the regulations and they were published, then of course they all could have seen them, and all ought to have known. And if they did not issue the regulations, then of course you could not find out, unless by an investigation, as you say.

Mr. MANSON. You could not tell under the regulations whether a claim like the Aniline claim was wrong or not. There isn't anything in the regulations.

Senator REED of Pennsylvania. Now, can we not go ahead with Mr. Gregg?

The CHAIRMAN. Yes; proceed, Mr. Gregg.

Mr. GREGG. That was all I wanted to point out in connection with the National Aniline & Chemical Co. case.

Another question which arose in connection with the administration of this section of the act, and that is criticized in the report, arises in cases where the assets to be amortized are owned by a subsidiary. I will give a specific example, one that was considered by the committee, because it illustrates the point very well. Take the case of the Standifer Shipbuilding Co., which in 1917 or 1918 built housing facilities to house its employees. It borrowed the money, as I remember, from the Shipping Board, from some governmental agency.

The CHAIRMAN. The Housing Corporation.

Mr. GREGG. Yes, which required that the title to these properties, money for which was borrowed from the Government, should be retained in a separate corporation. So the company purchased these housing facilities and separately incorporated a housing company to hold title to these properties. If these housing properties had been owned by the shipbuilding company there is no argument but that the company would have been entitled to amortization on the facilities. Now the fact that the company has separately incorporated these housing facilities at the request of a governmental agency prevents the corporation from getting amortization. In some cases before that question was presented to the Solicitor's office amortization was tentatively allowed in such cases. It seems

to me that the equities of it are so plain, are so obvious that conversely from the National Aniline & Chemical Co., if Congress had had that case before it would have allowed the amortization.

That action of the bureau which is criticized is now up before the Board of Tax Appeals, and will be settled when the Standifer case, which is now pending there, is finally decided. A question, however, of that sort, with all the equities in the world in favor of the taxpayer, does not in my opinion afford ground for any criticism of the action of the bureau.

Mr. MANSON. Let me ask you this question, Mr. Gregg. Do you believe that a railroad which is a common carrier engaged in a general railroad business, but whose stock happens to be owned by the United States Steel Co., is entitled any rights under this statute that the Pennsylvania Railroad or the Atchison, Topeka & Santa Fe Railroad are not entitled to?

Senator WATSON. Well, amortization is not permitted to railroads.

Mr. GREGG. That question is best answered, Mr. Manson, in my opinion, which holds that neither of them is entitled to amortization.

Mr. MANSON. Does not that bring you back to this question that to be entitled to amortization the taxpayer must produce an article contributing to the prosecution of the war? Now in connection with the National Aniline & Chemical Co. settlement, you justify that settlement upon the ground of the separate corporate entity. Now if you are going to recognize a separate corporate entity for the purpose of allowing amortization, why should you not also recognize a separate corporate entity when that separate corporate entity does not produce an article contributing to the prosecution of the war?

Senator REED of Pennsylvania. I understand that the trouble is that they have adopted your suggestion and have not allowed amortization.

Mr. MANSON. Well, I have pointed out here quite a number of millions of dollars of amortization allowances which have been granted to corporations that would not have been otherwise entitled to amortization which were allowed it because their stock was owned by corporations that were entitled to amortization.

Mr. GREGG. The recent solicitor's opinion, which is now being used by the bureau in the settlement of all amortization cases, holds that amortization in such a case as that is not permissible. I doubt very seriously its correctness, and I doubt very seriously that we will be able to sustain it. I wanted to bring out that case to show the difficulty of the question, and to show another case in contrast to the National Aniline & Chemical Co. case, where we have been forced under the statute to reach a result which is against the taxpayer, which I think is clearly contrary to what Congress would have then done if they could have foreseen the question and covered it.

Senator WATSON. What is the decision up to this time in the Standifer ship case?

Mr. GREGG. It has not been decided yet.

Senator SHORTRIDGE. What is the case?

Mr. GREGG. The Standifer ship case, which company separately incorporated its housing facilities, and the question is whether they are entitled to amortization, or whether they are deprived of amortization because their housing facilities were owned by a subsidiary rather than by the parent itself.

Senator SHORTRIDGE. You hold that they were not entitled to amortization?

Mr. GREGG. I hold that they were not entitled to amortization.

Senator SHORTRIDGE. And it is now on appeal before the board?

Mr. GREGG. Yes, sir.

The policy of the department which has been most criticised by the committee probably is in the application of this formula determining postwar value in use. We are criticized very severely in certain instances for grouping facilities in determining postwar value in use rather than comparing the war capacity with the postwar use of each individual facility. In other words, in some instances we have grouped the facilities in a given department of a concern, and compared their war capacity with their postwar use. We are criticised for not comparing the actual use of each facility in the postwar period with its war capacity.

In the opinion which, I say, has now been issued for the guidance of the bureau in amortization cases, it is held that wherever possible a comparison should be made of the specific facilities, and that grouping should be done only when comparison of the facilities is impossible, and the action in grouping facilities should be safeguarded in every way possible.

The reasons for the action on that question are these. It is obviously more correct in determining the loss in use to compare the postwar use of the individual facility with its war capacity. However, to show the practical difficulties, take the case of the United States Steel Corporation. That corporation expended during the war two hundred and forty some million dollars in capital expenditures on which it claimed amortization. It was admittedly entitled to amortization at least based upon postwar replacement cost. It claimed it also on reduced value in use. The administrative burden of taking each facility included in that two hundred fifty million, in round figures, of capital expenditures and comparing the postwar use of each facility with its war capacity demonstrates, clearly, the administrative impossibility of such a rule. We have relaxed the rule only where it is necessary as a matter of administrative procedure.

Now summing up the criticisms of amortization and our answer, I would like to point out first that of the amortization cases amounting to $600,000,000 that have been allowed, counsel for the committee figures that there are about $139,000,000 still open. I can not question or affirm the correctness of those figures. He also stated that he was in substantial accord with the views expressed in this last opinion, which opinion is being used as the basis of all amortization settlements at the present time, and as I stated to the investigating committee, will be used as the basis for the settlement of all cases which are not finally closed.

It seems to me that the point we come to is this, that we now have issued, after some eight years of experience with the statute, a set of rules which represent our best and latest thought on the subject. We are going to close all unclosed cases in accordance with that ruling. With that ruling the committee differs very little, if at all. Therefore, I do not see anything to be gained by any statutory provision; I do not see the necessity for any statutory provision on the subject.

The CHAIRMAN. Have you a copy of that ruling that you spoke of?

Mr. GREGG. I have a copy of it; yes.

The CHAIRMAN. Will you put it in the record at this point?

Mr. GREGG. I will put it in the record.

(The ruling presented by Mr. Gregg for the record is here printed in full, as follows:)

[Section 214(a)9.—Deductions allowed: Amortization. Article 184: Computation of amortization allowance. Revenue acts of 1918 and 1921. Computation of amortization allowance. Solicitor's opinion 138 (C. B. I-1,174), modified and I. T. 2,101 (C. B. III-2,141), amplified]

The opinion of this office is requested relative to a number of questions pertaining to the determination of the amortization allowance of the M corporation.

The facts are as follows:

In its original returns the taxpayer claimed amortization in various amounts on the different properties of its subsidiaries, the total amount claimed being 181x dollars. This claim was disallowed, and the taxpayer filed a revised claim in the total amount of 197x dollars. An investigation of this claim was made and a report submitted, in which, after several conferences resulting in a number of corrections and adjustments on different properties (as shown in supplemental reports), amortization in the sum of 132x dollars was recommended.

This amount was based largely upon an estimate of the taxpayer's production during 1922 and 1923, and, as it subsequently developed that actual production during those years was somewhat larger than estimated, a question arose in the bureau as to whether the amortization allowance recommended in the engineers' report should be corrected accordingly.

This matter was discussed in conference on January —, 1924, and an agreement was made at that time between the several engineers of the engineering division and the taxpayer's representative that no change should be made in the engineers' report. This agreement was concurred in by the representatives of the engineering and audit divisions present and by the taxpayer's representative, but no formal acceptance of it was ever filed nor has any assessment letter based on this agreement ever been issued.

Under date of January —, 1925, instructions were given by the commissioner that the report on the taxpayer's amortization claim be reconsidered, using actual production figures of 1922 and 1923 and eliminating all allowances recommended on facilities owned by common carriers.

At a hearing on July —, 1925, the taxpayer questioned the authority to issue the order of January —, 1925, contending that there had been a final allowance of its amortization claim prior to March 3, 1924.

In support of its contention the taxpayer refers to certain memoranda of the conference held on January —, 1924, between various employees of the engineering division, a conferee, and the representative of the taxpayer. The first of these memoranda was addressed to the head of the engineering division and was signed by the assistant chief of the nonmetals section, three engineers, and a conferee. It stated in substance that the conference had been held to determine the advisability of opening the amortization case of the taxpayer for the purpose of reducing the proposed amortization allowance because of the excess of the taxpayer's actual production for the year 1923 over the production as estimated by the bureau; that it had been agreed between the conferees that if the case were opened the probabilities were that the proposal for a reduction in amortization due to increased production by the taxpayer in 1923 would be offset by the taxpayer's claim that the bureau had disregarded the company's large production during the year 1916, which if taken into consideration would have resulted in a material increase in amortization.

The second conference memorandum, dated the same day, set forth in substance that the purpose of the conference was to discuss facts dealing with the permanent closing of taxpayer's amortization case; that the taxpayer had stated that all data pertaining to its case had been presented and it was satisfied to have the case closed on the evidence submitted and the allowance recommended; that it was agreed that the closing of the taxpayer's case was subject to adjustment of the values of certain facilities which were embodied in the claim of the taxpayer's subsidiary, the O Company.

In further support of its contention, the taxpayer calls attention to the fact that following the writing of these conference memoranda it was furnished with a supplemental report relative to the O Company, which was signed by two of the bureau's engineers and dated January —, 1924. This report was marked "final", and reference was made therein to the conference of January —, 1924. The conference memoranda above referred to were transmitted to the taxpayer by a letter dated February —, 1924, which was signed in the name of Deputy Commissioner Bright by a chief of section. On the basis of these documents taxpayer argues that its amortization deduction was finally allowed.

While the language of the conference memoranda above referred to speaks of the final closing of the amortization case, this language must be considered from the viewpoint of the persons using it. The memoranda are evidence of nothing more than an agreement of certain members of the Income Tax Unit, and they can not bind the bureau or the commissioner. The engineering division had no authority to finally allow a claim for amortization. It was and is the function of that division to make examinations and reports on claims for amortization and to submit recommendations as to amortization allowances, but such reports are not in any sense the final allowance of the deduction by the bureau. After the report of the engineer is completed it is sent to an audit section, where the figures are checked. In many cases a field audit is made. When the audit is completed it must be reviewed in a review section and the proposed allowance subjected to further consideration. From the review section the case passes to the head of the division, and in cases of additional assessments from the head of the division to the deputy commissioner, by whom the assessment letter is signed. The procedure of the bureau whereby returns are forwarded to an audit section after consideration by the engineering division is well known to taxpayers in general, as evidenced by the chart in the work entitled "Income Tax Procedure," by R. H. Montgomery (1924 ed., p. 207).

Under the procedure that existed at the time the alleged final allowance was made the taxpayer might have appealed to the committee on appeals and review from the action of the income tax unit on its amortization claim. It is also to be observed that had a refund for more than $50,000 been proposed for the years involved in the amortization claim the action of the unit would have been subject to review by this office, with the possible result of a revision or disallowance of the proposed amortization deduction.

Under such a procedure it is apparent that any agreement made by the engineering division can not be binding upon those who audit and review the case. At best such an agreement could mean merely that the case was to be closed so far as the engineering division was concerned. That the taxpayer was put upon notice of the limited effect of the agreement of January —, 1924, is clearly disclosed by a statement which was contained in each of the reports on the various subsidiaries of the parent corporation. This statement also appears in the so-called "'final" report of the engineers on the O Company, dated January —, 1924, on which much reliance is placed by the taxpayer. The statement referred to reads as follows:

"The costs and contractual amortization are subject to check by the auditor or revenue agent assigned to the field investigation of this case."

It is obvious from this statement, which was contained in the report on each of the subsidiary companies involved, that the report was in no sense a final allowance, but was subject to check and further investigation. Furthermore, each report of the engineers is made in the form of a recommendation for an allowance and not in the form of a final allowance, the language used being:

"It is recommended that (name) be allowed amortization in the sum of $——— on property costs indicated above."

These statements show clearly that the report was simply a recommendation of the engineering division as to the amortization allowance which was yet to be made, and that the recommendation was subject to further consideration and check.

As a matter of fact, there has never been a complete audit of this taxpayer's case, to say nothing of a review of the audit or the sending out of notice of a proposed assessment. The action so far taken has merely been that of the engineering division, supplemented by a partial field audit of the taxpayer's return. The recommendation of the engineering division has never been acted upon by any official of the bureau having authority to allow an amortization deduction. In view of the actual facts of the case, of which the taxpayer had

ample means of knowledge, there is no foundation for the assertion that there was a "final" allowance of an amortization deduction to this taxpayer.

As has been stated, the taxpayer's original claim for amortization was disallowed. Assuming that such disallowance was a determination by the commissioner, the question arises as to the authority of the commissioner to redetermine the taxpayer's amortization allowance under the circumstances presented.

Section 234(a)8 of the revenue act of 1918 provides in part that—

"At any time within three years after the termination of the present war, the commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined; and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252 * * *."

A similar provision is contained in the revenue act of 1921, the principal difference being that the words "at any time before March 3, 1924," are substituted for the words "at any time within three years after the termination of the present war." This difference, however, is not material, since the termination of the war was fixed by congressional resolution as March 3, 1921, and three years after that date was March 3, 1924.

From the foregoing language the inference is clear that March 3, 1924, was not the final date when the commissioner's redetermination was required to be completed, but was intended as the date before which the request by the taxpayer should be made or the reexamination of the return by the bureau must be begun. To hold otherwise would bring about the result that the taxpayer could request a reexamination of the return on March 2, 1924, and the commissioner would be compelled to make a redetermination of the tax on the same day. This, of course, would be a physical impossibility, and that such was not the intention of Congress is clearly indicated by the third proviso of section 250(d) of the revenue act of 1921, which reads as follows:

"*Provided further*, That in cases coming within the scope of paragraph (1) of subdivision (a) of section 214, or of paragraph (8) of subdivision (a) of section 234, or in cases of final settlement of losses and other deductions tentatively allowed by the commissioner pending a determination of the exact amount deductible, the amount of tax or deficiency in tax due may be determined, assessed, and collected at any time; * * *."

In the instant case the taxpayer made a request for the reexamination and redetermination of its amortization deduction before March 3, 1924. Its revised claim was filed and partially examined long prior to that date. However, on March 3, 1924, there had been no redetermination or allowance of the deduction claimed; there was merely a recommendation from the engineering division as to the amount allowable. This recommendation showed on its face that it was subject to revision, and the fact that it was in no sense final was apparent from the well-established procedure of the bureau. Therefore, on March 3, 1924, and at the present time the amortization deduction was and is in the process of redetermination. There is no limitation upon the time within which this redetermination, which was begun within the statutory period, may be made, but if a deficiency in tax results from the redetermination such deficiency must be assessed within the time prescribed in sections 277 and 278 of the revenue act of 1924.

It is asserted that the bureau now has no authority to make a redetermination of the amortization because, by Section 1100 of the revenue act of 1924, Title II of the revenue act of 1921, relating to the income tax, is specifically repealed and all discretionary authority over deductions for amortization has been taken away from the commissioner.

This assertion does not take into consideration the provisions of section 1100 (b) of the revenue act of 1924, which are as follows:

"The parts of the revenue act of 1921 which are repealed by this act shall (except as provided in sections 280 and 316 and except as otherwise specifically provided in this act) remain in force for the assessment, and collection of all taxes imposed by such act, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes, and for the assessment and collection, to the extent provided in the revenue act of 1921, of all taxes imposed by prior income, war-

profits, or excess-profits tax acts, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes. In the case of any tax imposed by any part of the revenue act of 1921 repealed by this act, if there is a tax imposed by this act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this act takes effect under the provisions of this act."

Similar provisions are contained in section 1400 (b) of the revenue act of 1921, saving the substantive provisions of the revenue act of 1918.

Section 280 of the revenue act of 1924, to which reference is made in section 1100 (b), above quoted, provides that:

"If after the enactment of this act the commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by the revenue act of 1921, or by any such act as amended, the amount which should be assessed (whether as deficiency or as interest, penalty, or other addition to the tax) shall be computed as if this act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand) as in the case of the taxes imposed by this title, except as otherwise provided in section 277."

It is thus apparent that all of the substantive provisions of the prior laws relating to amortization deductions, i. e., those dealing with the right to the deduction and assertion of such right, have been preserved under the present act and that merely procedural provisions, those dealing with the assessment, collection, and payment of the tax, have been superseded by the present act.

In a memorandum from the Income Tax Unit under date of May —, 1925, information is requested as to whether the reconsideration of the claim should be restricted to the features specifically mentioned in the order of January —, 1925, or whether the reconsideration of the claim should be made on the basis of the rulings and regulations now in effect.

Since there has never been an allowance of amortization in this case, and as the claim is still under consideration, it is the opinion of this office that the claim should be examined and the allowance determined in accordance with the existing interpretations of the law.

It is argued by the taxpayer that because of a statement made in 1921 by the then head of the amortization section of the Income Tax Unit that certain facilities, including the common-carrier railroads of the taxpayer, were subject to amortization, this statement and its acceptance by the taxpayer, constituted an agreement which is now binding upon the commissioner. Suffice it to say that the chief of the amortization section had no authority to make such an agreement, and the commissioner is not now bound to adhere to his views as to what is allowable under the law for amortization deductions.

The taxpayer asserts the right in the case of a reconsideration to claim additional amortization deductions for facilities previously examined as well as additional deductions for facilities which were not included in its revised claim.

In view of the fact that there has been no redetermination of the taxpayer's allowance and as the case is still under consideration by the bureau there appears to be no good reason why the taxpayer should not now be permitted to show that it is entitled to additional amounts of amortization on any facilities and upon any basis that it desires to present, provided such basis is recognized by the regulations of the bureau and the rulings thereunder. Under the language of section 234 (a) 8 of the revenue acts of 1918 and 1921, heretofore quoted, it was only necessary for the taxpayer to request the redetermination of its amortization allowance prior to March 3, 1924, and it then became the duty of the commissioner to make such redetermination. There is nothing in the statute which requires the basis of the allowance to remain unchanged or which requires that the facilities on which the allowance is predicated should remain the same. What is to be redetermined is the taxpayer's allowance for amortization, not merely the accuracy of the claim which the taxpayer has presented. The statute reads:

"* * * the commissioner may, and at the request of the taxpayer shall, reexamine the return and if he then finds *as a result of an appraisal or from other evidence* that the deduction originally allowed was incorrect the taxes * * * shall be redetermined, etc."

It appears clear from the language in italics that the reexamination and redetermination was not intended to be limited to the facts set up in the taxpayer's claim, but that "other evidence" could also be considered. There is no reason why the taxpayer should not present such "other evidence" as it is able to procure prior to a redetermination of its allowance. It is to be borne in mind that the present ruling applies only in a case where request for redetermination is made by the taxpayer prior to March 3, 1924, and one in which a redetermination of the allowance has not been made by the bureau. The views herein expressed are in conflict with some of the langauge used in solicitor's opinion 138 (C. B. I-1, 174), which is modified accordingly.

In the unit's memorandum of May —, 1925, 16 questions are submitted for the opinion of this office. The questions and their answers are as follows:

1. In the report of the engineers, amortization was recommended upon a number of facilities, such as housing projects, that are owned by subsidiary corporations which did not themselves engage in the production of any article contributing to the prosecution of the war (for example, amortization was recommended in the case of the P Land Co. on a housing project constructed and maintained by it for the employees of another subsidiary, the Q Shipbuilding Co.). In the reconsideration of this case under present rulings, should these recommendations be sustained?

2. Amortization was also recommended in several instances upon facilities owned by one corporation but leased to and operated by another subsidiary. As an example of this, amortization was recommended upon a plant which is owned by the R Co. but leased to and operated by the S Co. Is amortization properly allowable on such facilities under present rulings?

In the opinion of this office a taxpayer which was not engaged in the actual production of articles contributing to the prosecution of the war is not entitled to amortization. This is in accord with the previous rulings of this office. No allowance should therefore be made in the cases above cited.

3. Article 184(2), Regulations 62, provides that value in use is to be "not greater than the estimated cost of replacement under normal postwar conditions." In the previous consideration of this case the allowances recommended on the basis of postwar replacement costs were computed in accordance with the ratios prescribed in Treasury Decision 3333 (C. B. I-1,178) for computing tentative allowances for amortization. If these ratios are now disregarded, as it appears should be done in the redetermination of amortization claims, should the average prices of labor and materials during the period from March 3, 1921, to March 3, 1924, be taken, under the law and the regulations, as indicative of replacement cost "under normal postwar conditions," or should the prices existing at the end of that period be so taken; or should prices subsequent to that date, and now known, be given consideration?

Inasmuch as the revenue acts of 1918 and 1921 fix March 3, 1924, as the time limit within which a redetermination of an amortization deduction must have been demanded by a taxpayer, it was evidently the view of Congress that the postwar period for amortization purposes would end on that date. The final date of the ending of the war was fixed by congressional resolution as March 3, 1921. The postwar period for amortization purposes was, therefore, from March 3, 1921, to March 3, 1924. However it is well recognized that the year 1921 was, in most industries, a period of severe depression, following the inflationary boom of 1919 and 1920, and it is apparent that statistics on costs of facilities during that year may not be indicative of the normal cost of these facilities. It is to be presumed that the further away from the war period and from the subsequent periods of inflation and depression the costs are considered the more nearly normal are such costs likely to be. This presumption may not be true in all cases, but it is the opinion of this office that as a general rule the prices for determining postwar replacement costs should be taken as near to March 3, 1924, as is practicable, having in mind the selection of a time within the period March 3, 1921, to March 3, 1924, when the prices to be decided upon are not affected by abnormal conditions but are nearest normal.

4. In the determination of the amortization allowable on the several facilities comprising an entire plant or project, should the allowance made be based upon the postwar replacement cost of the entire plant or project, or should consideration be given the postwar replacement cost of individual items, even though the replacement cost of the entire project is greater than actual cost?

Amortization allowances made on the basis of postwar replacement costs should in all cases be computed on replacement costs of complete units. An allowance, for instance, should not be made on the basis of replacement costs of part of a building, but should be based on the cost of the entire building as completed. However, allowance may be made on the replacement costs of the machinery and equipment of a building or even complete individual units of such machinery and equipment, without regard to the cost of the building or the cost of other units of machinery and equipment on which no allowance on the basis of replacement costs is claimed. The amortization allowable on any complete unit on the basis of replacement cost should not be decreased by the fact that the replacement cost of other units in the taxpayer's claim may be greater than actual cost.

5. Article 184(2), Regulations 62, provides that the value in use of amortized facilities is to be not greater than postwar replacement cost. Value in use, from an engineering viewpoint, may depend upon the amount of use received as compared with capacity, or upon replacement cost, or upon both of these factors. Should article 184(2) be interpreted as meaning that if value in use as shown by relative production and capacity is less than replacement cost, no consideration should be given replacement cost; or should consideration be given both excess capacity and postwar replacement cost, in the determination of amortization allowance? (For example, a taxpayer during the war period installed 50 machines at a cost of $100 each, and his postwar business only requires 30 of these machines, which can be replaced at a normal postwar cost of $80 each. All of the 50 machines are used more or less and their value in use is estimated, on the basis of production, at 60 per cent of cost. Should that percentage be applied to the original cost of the machines, or to their postwar replacement cost, in computing the amortization allowable?)

The value in use of amortized facilities to the taxpayer in its going business in the case of individual items is in general best reflected by the depreciated normal postwar cost of similar facilities of the proper size or capacity for meeting the requirements of the taxpayer's postwar commercial business during and for the term of years the facility under consideration may reasonably be expected to function efficiently. However, the preceding should apply only to the fixing of values in use of individual units or item of equipment. In all cases of where values in use are based upon the application of average percentages to groups of facilities in any one plant or department of a business in accordance with the method hereinafter described, such values should be computed by the application of these percentages to the original cost of the facilities and not to their estimated postwar replacement cost. It is evident that the ratios between the cost and capacity of different items may vary widely and such variation would prevent an accurate determination of the values of the miscellaneous items comprising such groups. Both excess capacity and lower postwar replacement cost can be given consideration on the same facility only in the case of individual items when the postwar cost of a similar facility of the proper size is definitely established.

6. Article 184(2), Regulation 62, provides that the value in use of amortized facilities shall not be less than their sale or salvage value, and article 184(1) provides that in the case of property sold or discarded there shall be added to the sale price or salvage value a reasonable allowance for depreciation, in case the property has been used in the taxpayer's business prior to its sale or discard and subsequent to the close of the amortization period. If items receiving only a small amount of use are found to have a value in use of less than salvage value, and the amortization allowance is based upon salvage value in accordance with article 184(2), should a reasonable allowance for depreciation be added to the salvage value for the use given such facilities as in the case of items actually discarded or sold?

Under the conditions mentioned the addition of a reasonable allowance for depreciation appears to be consistent with the similar deduction provided for by articles 184(1) and 188 of Regulations 62.

7. Under the provisions of article 184(1) and article 188 of Regulations 62, in the determination of the amortization properly allowable on facilities which have been sold, and as to which the allowance is to be based on the difference between cost and actual sale price, should the sale price be considered as the gross amount received, or should expenses, such as for advertising, commissions, cratings, and packing, or other similar items, which were necessarily incurred in making the sale and are directly attributable to the sale of the

amortized facilities, be deducted from the gross amount received and the net amount remaining be considered as the sale price?

The expenses of making the sale, such as for advertising, commissions, crating, packing, and similar items, may be deducted from the gross amount received if the expenses can be definitely established as resulting from the sale; otherwise they may not be deducted from the gross sale price.

8. In view of the specific reference to the date of March 3, 1924, in the two articles referred to in the previous question, should any consideration now be given sales, abandonments, or the restoration to use of any amortized facilities that were made subsequent to March 3, 1924, or should present determinations and redeterminations be based upon facts that were known or could have been ascertained on that date?

Article 184 (1) of regulations 62 provides:

"In the case of property which has been sold or permanently discarded, or which will be sold or permanently discarded before March 3, 1924, the value shall be the actual sale price, etc."

Article 188 provides:

"In the case of the bona fide sale of amortized property before March 3, 1924, the sale price thereof will be considered as reflecting the correctness or incorrectness of the amortization allowance made, due allowance being made for depreciation sustained since the close of the amortization period."

In view of these specific provisions of the regulations and of the provisions of the law heretofore discussed under question 3, it is the opinion of this office that present determinations should be based upon facts that were known and could have been ascertained on March 3, 1924, and not on facts learned subsequent to that date.

9. In the determination of values in use, should the period March 3, 1921, to March 3, 1924, be taken as indicative of normal postwar conditions, or should conditions either prior or subsequent to that period be given consideration?

As stated in the answer to question 3, inasmuch as the revenue acts of 1918 and 1921 fix March 3, 1924, as the time limit within which a redetermination of an amortization deduction must have been demanded by a taxpayer, it was evidently the view of Congress that the postwar period for amortization purposes would end on that date. Since the final date for the ending of the war was fixed by congressional resolution as March 3, 1921, the postwar period for amortization purposes began on March 3, 1921, and ended on March 3, 1924. It is clear that the value in use of a facility does not depend upon the use to which it is put on any given day, but should be arrived at by a consideration of the use of the facility over a period of time. It is therefore the opinion of this office that as a general rule the average use given to a facility over the period from March 3, 1921, to March 3, 1924, is indicative of the value in use of such facility. However, where evidence exists that any one of these years, such, for instance, as the year 1921, is manifestly not indicative of normal postwar conditions, the use of the facility during such year may be disregarded and the average of the remainder of the period may be taken.

10. Article 182, regulations 62, provides that "the allowance for amortization shall be inclusive of all depreciation during the amortization period on property subject to amortization." Should this provision be interpreted as meaning that the amortization allowance is to be in lieu of depreciation and that no depreciation is to be allowed on facilities on which amortization is allowed; or that such depreciation as is properly allowable on amortized facilities is to be added to and included in the amortization allowance?

It is the opinion of this office that under article 182, regulations 62, the amortization allowance is to be in lieu of depreciation, and if depreciation is greater than amortization, then depreciation alone should be allowed. This view, however, is not to be understood as affecting that part of article 184(2) providing that the value in use is not to be greater than "the estimated cost of replacement under normal postwar conditions less depreciation and depletion."

11. In the reconsideration of the taxpayer's amortization claim should the amortization allowance be limited to the items included in the claim as filed, and to the amounts claimed on those items, and to the bases on which those amounts were claimed, or should allowances now be made, if found justifiable, on facilities previously supposed to be not amortizable and for that reason

not included in the taxpayer's claim, but which as a result of subsequent rulings are now considered amortizable?

This question has already been answered in the general discussion just prior to the consideration of question 1.

12. Under article 185, Regulations 62, should the end of a taxpayer's amortization period be placed at the date on which the larger part of its war work was completed, or should the "date of cessation of operation as a war facility" be placed at the final date of completion of all war work?

Under the above-cited regulations a taxpayer's amortization allowance is apportioned over the period from January 1, 1918, to the date of the cessation of operations as a war facility. The latter date need not necessarily be the exact date on which the final act of completion of any or all of the taxpayer's war contracts was performed, but should be placed at such date as will include all manufacturing operations of any reasonable magnitude as compared with the total volume of taxpayer's production. In this connection it should be particularly borne in mind that the fixing of a date as the end of the taxpayer's amortization is claimed, which replaced similar pre-war units that were at that mean that amortization is allowable upon any or all of the expenditures made prior to that date. This question depends upon whether the facilities acquired after 1918 were acquired for war work or for commercial purposes.

13. In the case of facilities acquired during the war period and on which amortization is claimed, which replaced similar pre-war units that were at that time partly or wholly worn out or were inadequate for the production required, or which had been destroyed by fire, flood, or other accident, if it is satisfactorily proven that the amortized facilities were used in the production of articles contributing to the prosecution of the war, should the question of whether the amortized facilities were for war work, or were acquired to replace prewar commercial facilities be given consideation, and if the facilities in question are considered properly amortizable, should the amount of the allowance be decreased either because of the capacity or of the book value of the pre-war units that were replaced?

The fact that a facility replaced a similar unit which was in operation during the pre-war period, but which became obsolete or which had been destroyed, does not alter the fact that the taxpayer may have installed the new facility for the production of articles contributing to the prosecution of the war and that the cost of installation or acquisition may have greatly exceeded the cost of replacing the same facility in the postwar period. Prior to the acquisition of the new facility the taxpayer had the option of replacing the facility and continuing with the work of producing war article or of discontinuing the work of production and not replacing the facility until the postwar business outlook became more certain and until lower replacement costs prevail. If he chose the former alternative, he would appear to be entitled to amortization. It is therefore the view of this office that in cases where facilities, acquired during the war period and on which amortization is claimed, are found to have replaced similar pre-war units that were at that time partly or wholly worn out or obsolete or which had been destroyed by fire, flood, or other accident, if it is satisfactorily established that the new facilities were constructed or acquired for the production of articles contributing to the prosecution of the war, their entire cost should be considered properly subject to amortization on the same basis as if no previous units had existed.

14. In the case of facilities commenced prior to the end of the taxpayer's amortization period and completed after that date, if it is found that such facilities were in fact commenced because of the requirements of the taxpayer's war work, and are, therefore, properly amortizable, but that the construction of the project had not advanced to a state such that its completion should be considered an economic necessity, should the amortization allowance be limited to the loss suffered on that part of the cost incurred prior to the end of the amortization period, or should it be limited by (*a*) the loss (including actual commitments) that would have occurred if construction had been discontinued or (*b*) the actual loss that has occurred through completion and operation of the facility, whichever is greater?

In cases where the taxpayer had not carried its facilities to such a degree of completion that it would have been an economic waste to leave them uncompleted or where amounts had not been actually paid out or work had not progressed to such a state that good business judgment required carrying the contract to completion, it is the opinion of this office that the amortization allowance should be limited to (*a*) the loss that would have occurred if con-

struction had been discontinued on November 11, 1918 (including the loss arising from enforceable contractural obligations existing on that date), or (*b*) the actual loss that has occurred through completion and operation of the facility, whichever is less. In I. T. 2101 (C. B. III-2,141) it was held that the amortization allowance in such a case should not be greater than the amount the taxpayer would have had to pay had he decided to cancel the contract. The method suggested in question 14 might result in a greater allowance than that specified in I. T. 2101 and is therefore not believed to be proper.

15. In the case of facilities for the production of articles contributing to the prosecution of the war which at the date of the signing of the armistice were in the course of construction but were not intended for the completion of any war contracts previously entered into, should the amortization allowance be rigidly based on expenditures and commitments as of that date; or in view of the conditions then existing and the question of whether a taxpayer under those conditions could have been reasonably expected to instantly decide whether to continue or abandon such construction, should the amortization allowance on such uncompleted facilities be based upon expenditures and commitments as of December 31, 1918?

In view of the uncertain conditions existing immediately subsequent to the signing of the armistice on November 11, 1918, and in view of the fact that a taxpayer under those conditions could not reasonably have been expected to decide immediately whether to continue or abandon the construction or installation of a facility commenced prior to that date, amortization should be allowed on expenditures made prior to December 31, 1918. However, this should not apply in the case of contracts entered into or expenditures made for entirely new facilities commenced after November 11, 1918, except where such facilities are shown to have been necessary for carrying out uncompleted war contracts or subcontracts of the taxpayer. Where car contracts entered into by a taxpayer prior to November 11, 1918, were not completed until after that date, careful scrutiny should be given all subsequent expenditures and amortization should be allowed on facilities subsequently acquired only with respect to such items as are satisfactorily proven to have been necessary for the carrying out of the taxpayer's war contracts. Expenditures made for the purpose of restoring the taxpayer's plant to the condition necessary for carrying on postwar normal business are not subject to amortization.

16. In the previous consideration of the taxpayer's claim in the instant case the method followed by the engineers in fixing the value in use of amortized facilities was based on the relative capacity and production of the taxpayer's combined plants. Values of the individual plants under postwar conditions have admittedly been widely different from that of the average of all plants combined. Upon the reconsideration of this claim, should the method for fixing the postwar values of the amortized facilities at each plant be based upon the capacity and production of all plants combined as previously computed, or upon the capacity and production of the individual plant at which such facilities are located?

I. T. 2101, supra, states among other things that:

"In determining the value in use for the purpose of amortization deduction, it is necessary to determine such value as to the specific facilities erected or acquired for production of articles contributing to the prosecution of the war, and in doing so it must be determined, first, whether the specific facilities are being used to their full normal capacity, and, second, whether such capacity is needed for the postwar business."

It is realized by this office that in many cases it is impracticable, because of the exceedingly large number of facilities involved and because of the absence of proper records as to such facilities, to make an examination and comparison of each specific facility; but such examination should be made wherever practical. The more often the examination and comparison can be made of individual facilities the more nearly accurate will be the determination of value in use. Where the examination of the individual facilities is not practicable the examination should be made by groups of machines or by departments of the business in accordance with the following general method:

In cases where values in use are based upon departmental or plant production, a sufficiently detailed analysis of the operation of the department or plant should be made to show that the assigned residual values correctly reflect the true average value in use of all amortized facilities of the department or plant, and if any items are found to have individual values distinctly different from that of the department or plant, the values of such items should be determined

separately. Particular attention should be given to such items as may reasonably be considered to be indispensable in the operation of the plant, even though only occasionally used, and if it is found that the taxpayer's normal business, regardless of its actual volume, requires such facilities, no amortization should be alowed on such items except on the basis of lower replacement costs.

Where the amortized facilities are in postwar use in connection with similar prewar units, if records are obtainable of the actual amount of use given to each of the groups, the value in use of the amortizable items should be based upon the actual amount of use received by them. If such records are not available, and the value of the amortizable items has to be based on the total amount of use given both groups combined, a decision should be reached as to whether the amortizable items are in better condition or capable of more economical operation to such a degree that their value in use is greater than that of the older prewar units, and if such is found to be the case their value in use should be ascertained accordingly. If, on the other hand, it is satisfactorily proven that the taxpayer has ample prewar facilities for all of its postwar commercial requirements of equal efficiency to those acquired for war work, consideration should be given this factor in ascertaining the value in use of the amortized facilities. In all such cases the extent to which facilities are in use shall be considered substantial proof that the value of their use is in direct proportion to the amount of use given them unless it is definitely established that such use has a lower or higher value by reason of the peculiar conditions in the individual cases.

In computing the percentage that postwar production bears to capacity, care should be exercised to ascertain the normal capacity of the facility as equipped and operated during the war period and for continuous operation over a term of subsequent years. The best evidence of this is actual production. It should ordinarily be assumed that all facilities used in war work during 1918 were operated to capacity during that year and no greater capacity should be accepted for any facility than is proven by its 1918 production, if in operation in that year, unless such greater capacity is definitely proven. If the facility was completed too late to be placed in full operation in 1918, its actual capacity should be satisfactorily established by later production, and rated capacities should be accepted only in such cases where it can be proven that capacity production has never been obtained and where such rated capacities are properly substantiated. If the nature of the business is such that in normal times an excess of capacity over production is required to meet the demands of the business, that fact should be taken into consideration in ascertaining the postwar capacity required by the business and in ascertaining whether or not there has been a loss of useful value.

A. W. GREGG,
Solicitor of Internal Revenue.

Senator WATSON. I would like to have you call attention to the difference in the application of the rule in the different instances that have been cited here, like the Bethlehem Steel and the United States Steel.

Mr. GREGG. Yes. The United States Steel case has not been settled yet. The general rules for this settlement have been laid down. The Bethlehem Steel case was never considered by the committee, and I do not know the decision. All I know is that neither has been finally settled. So I am not in a position to compare the results in two cases neither of which have been settled.

Senator WADSWORTH. How about the McKeesport Tin Plate and the Berwind-White cases?

Mr. GREGG. The Berwind-White case was discussed in committee, and I am quite familiar with it. The McKeesport Tin Plate case was not discussed in committee, and the first time I saw anything about it was in the report, and I am not familiar with it.

I can take up the Berwind-White case and discuss its points, and show the reasons for the department's actions in that case, and I think I can show that its facts were so peculiar that no other case

can be compared with it without a very careful examination of the facts to see if they are at all comparable.

Senator COUZENS. May I ask you at that point, Mr. Gregg, if there was any difficulty in determining the actual facilities and the averaging of them in his case?

Mr. GREGG. In which case, sir?

Senator COUZENS. The Berwind-White. A while ago you pointed out to the committee the difficulties of arriving at amortization on specific facilities purchased for war purposes, and that you had to as a matter of practical application group them all.

Mr. GREGG. Yes, sir.

Senator COUZENS. I ask you if that difficulty existed in the Berwind-White case?

Mr. GREGG. I did not. You had one facility in the Berwind-White case. You did not have a matter of $250,000,000 of capital expenditures, and a great many types of expenditures..

Senator COUZENS. That is the point I want to bring out. And yet they were grouped?

Mr. GREGG. I do not think they were grouped. Would the committee like for me to take up the case of the Berwind-White Co. and discuss it?

Senator WATSON. Yes.

Mr. GREGG. You remember I discussed the Berwind-White case when the matter of the extension of the investigating committee was before this committee. I am a little hazy now in my recollection, but I think I can state the facts correctly. As I recall, the Berwind-White Company had a capacity, prewar capacity of approximately 9,000 kilowatts. During the war period to take care of its war load it bought new facilities which increased its capacity to approximately 19,000 kilowatts. In the postwar period it had a need for, as I remember it, 10,000 kilowatts.

The CHAIRMAN. Additional?

Mr. GREGG. No, sir. That was the total need. So we said that the acquisition during the war of the 10,000 additional kilowatts was a part of the war expenditure which should be written off against war income. And we allowed amortization on that facility of ten thousand nineteen thousandths of the war cost.

Two points are raised in objection to that. First, that this old pre-war plan was abandoned after the war, and second, that a new plant of an additional capacity of 10,000 kilowatts was acquired after the war, going to show that the postwar need was as great as the war need. As a matter of fact, after the war period the company, having both the old plant and the new plant on hand, retained fires under the boilers in the old plant to have reserve to take care of its peak load.

Right after the war period they had an opportunity to purchase a new plant of a capacity of 10,000 kilowatts, at approximately 50 per cent of the normal cost, due to the postwar depression. Therefore, having this opportunity to buy this additional plant at such a cheap figure, and to avoid carrying fires under two boilers, as they would have had to do if they had retained the old plant, although if they acquired the new plant they could use the fire under only one boiler, for economy of operation they purchased the new facility and discarded the old.

The department went very carefully into that case. After the committee brought it up we had one of our men whom we considered one of our best engineers go into it again to see whether on its own peculiar facts, and it does have quite peculiar facts, the allowance had been proper. After the most thorough consideration we determined that it had, the engineers so reporting, and allowed it to stand.

Senator REED of Pennsylvania. May I interrupt there?

Mr. GREGG. Yes.

Senator REED of Pennsylvania. You say that this was an addition of a generator of 10,000 kilowatts made after the war?

Mr. GREGG. Yes.

Senator REED of Pennsylvania. Did they add boiler capacity so as to increase their power output?

Mr. GREGG. The boiler capacity, as I understand it, which they had to take care of their war plant was sufficient to take care of both it and the new plant which they acquired after the war.

Senator REED of Pennsylvania. Running simultaneously?

Mr. GREGG. Yes.

Mr. MANSON. No, no. They had enough boiler capacity to take care of 10,000 kilowatt production, which was all they did require, but they did require reserve in case one of the generators broke down.

Senator REED of Pennsylvania. They needed a spare, in other words?

Mr. MANSON. They needed a spare.

Senator REED of Pennsylvania. Yes.

Mr. MANSON. And they put in the spare generator in the new powerhouse, which was built during the war period.

Senator REED of Pennsylvania. So they did not increase their capacity?

Mr. MANSON. They did not increase their boiler capacity.

Senator REED of Pennsylvania. They did not increase their power capacity?

Mr. MANSON. No, sir.

Senator REED of Pennsylvania. It is just like a workingman having two saws; he can not use them both at one time, and it is still one man power though he has two saws.

Mr. MANSON. Yes.

Mr. GREGG. That was the point we made in connection with the case, that the action that the company had taken for economy of operation, getting the new plant to keep in reserve which could use the same boiler as their war plant and the scrapping of the old plant, purely as a matter of economy of operation, should not deprive them of amortization when it was admitted that after the war they had a postwar capacity of 19,000 kilowatts and a postwar need of only 10,000 kilowatts.

Mr. MANSON. Now, then, I would like to call the committee's attention to the fact that that method of determining amortization results in this. It results in giving to a lot of antiquated units the same value that is given to a brand new power plant, and automatically, of course, reducing the value of the new power plant by the

amount that you inflate the value of some plants that are on the scrap pile. Now, the only difference between the McKeesport case and this case is that the McKeesport case happened to be a steam plant. There they increased their boiler capacity. They had a lot of old boilers before the war. They put in some new boilers. After the war the new boilers were in actual use and the old boilers were not. They sought to do just exactly what the Berwind-White people did, namely, to have the capacity of their old boilers added to the capacity of their new boilers for the purpose of determining whether they had an excess capacity, and they were denied the right to do so both before and after the Berwind-White case was decided.

Senator REED of Pennsylvania. It looks like a discrimination.

Mr. GREGG. As I say, I am not familiar, and I have not had an opportunity to go into the McKeesport case. I am familiar with the Berwind-White case, and it seems to me that there was ample basis for the allowance in that case.

Senator JONES of New Mexico. Mr. Gregg, is there any justification for the fact that you do not take into consideration the fact that part of the plant is old and another part new?

Mr. GREGG. I think that we properly should, yes, sir; and the new ruling so holds. The fact that there may have been a difference of opinion in the past I do not think——

Senator REED of Pennsylvania. Then your new ruling practically concedes Mr. Manson's point as to the old facilities?

Mr. GREGG. It does not concede that there is no amortization of the facility acquired by the Berwind-White people during the war.

Senator REED of Pennsylvania. No, I did not mean that, but his last point that you should distinguish between old facilities abandoned and new facilities obtained?

Mr. GREGG. Adjustment should be made for the effectiveness of the facilities in the postwar period, of the efficiency; yes.

Senator REED of Pennsylvania. Is the McKeesport Tin Plate case closed?

Mr. GREGG. I do not know, sir. As I say, I never heard of it until I saw it referred to in the report.

Senator REED of Pennsylvania. It seems to me as though they were entitled to a review of it if it has not been closed.

Mr. GREGG. I should say if it has not been closed they would be entitled to review.

Mr. MANSON. I will give you another illustration of the same thing. The Firestone Tire Co. built an entirely new plant upon which they claimed amortization. At the time that amortization claim was investigated the engineer reported that that plant was working two shifts a day. So that was not only to capacity, but twice capacity. Yet they were allowed to amortize. How much was that, Mr. Parker? What percentage of amortization was the Firestone Tire Co. allowed there?

Mr. PARKER. $3,000,000.

Mr. MANSON. On a plant working two shifts a day, on the ground that the company did not have full use for it.

Senator REED of Pennsylvania. Was that for difference between cost and replacement value?

Mr. MANSON. No; that was for lack of use, and the way they got it was this. They had an old plant that they had abandoned the capacity of which was added to the capacity of the new plant for the purpose of determining what use they got out of the new plant.

The CHAIRMAN. Mr. Manson, nearly all the rubber companies during the World War were operating three 8-hour shifts every 24 hours. Do you know whether the Firestone Rubber Co. was?

Mr. MANSON. I do not know, but I do know this, that a man's plant can not be said to be a capital loss if he is not operating it 24 hours of the day.

The CHAIRMAN. I just asked the question whether you knew of it?

Mr. MANSON. No; I do not.

The CHAIRMAN. Because I know most all of the rubber plants were running the three 8-hour shifts.

Senator REED of Pennsylvania. Have you asked the bureau for an explanation or given them a chance to prepare an explanation of this Firestone case and this McKeesport case?

Mr. MANSON. No; I have not. I submitted my report on amortization; that is, the report that I prepared on amortization, to the bureau some time ago.

The CHAIRMAN. I wish you would furnish the committee, Mr. Gregg, with a statement of just what position the department took in those two cases.

Mr. GREGG. I shall have both cases looked into, Mr. Chairman.

The CHAIRMAN. And if there are any others, Mr. Manson.

Mr. MANSON. In connection with each point I have cited a long list of cases in this report. I have cited the cases where they have held one thing and I have cited the cases where they held the opposite.

Senator WATSON. Are these in addition to the cases that you brought before the committee?

Mr. MANSON. We have five or six cases before them.

Senator WATSON. You had five or six cases before the committee?

Mr. MANSON. Yes. Since then I have examined 168 cases.

Mr. GREGG. I have had no opportunity of looking into these cases.

Senator MCLEAN. Take the Firestone case, Mr. Manson. Was the capacity of the new plant greater than would have been the capacity if they had retained all the plants that had been abandoned?

Mr. MANSON. Oh, no.

Senator MCLEAN. Well, what was the difference? They scrapped some of their old plant?

Mr. MANSON. Well, I do not know as they scrapped it, but the new plant was working two shifts a day, which is evidence, I claim, that they needed all the capacity they had.

Senator WATSON. After the war?

Mr. MANSON. After the war.

Senator MCLEAN. After they had scrapped their old plants?

Mr. MANSON. Well, I do not think that they scrapped any plant, but I do think that they had some old plant that did not have the operating efficiency that the new plant had. Therefore that they used the new plant at least to the extent of two shifts a day.

The CHAIRMAN. Did they use the old plant during the war?

Mr. MANSON. Oh, yes; they used the old plant during the war, but my point is that when a plant is operating two shifts a day, that that is conclusive evidence that there has been no capital loss in building that plant other than the reduced war cost, of course.

Mr. GREGG. In the matter of inconsistency in the treatment of some of these cases which have been referred to, as I say, I can not tell whether there have been inconsistency in the treatment until I have had an opportunity to examine the particular cases. I have not had an opportunity to examine the case of the McKeesport Tin Plate Co. or of the Firestone Tire Co. cases. But if there has been inconsistency this should be corrected.

This last opinion which represents the present view and the last view of the department on this very complicated subject is based upon some eight years of experience in applying the law. Naturally during that time we have gained information through coming in contact with the different cases, we have gotten new points of view, and there has been, of course, some development in our procedure. The procedure is not to-day the same as it was five years ago. If it were I should have to admit that we had made no progress in the subject in the last five years. And it is quite natural that looking at the periods over which these cases have been adjusted, and the period during which this has been an active question, that is, from the time of the passage of the act to date, that there should be differences in the views of the department on this complicated matter.

Mr. MANSON. Well, is it not a fact, Mr. Gregg, that practically all of your amortization allowances—I do not say all, but practically all of them have been made since the 1st of January, 1922?

Mr. GREGG. The actual allowances probably have.

Mr. MANSON. Yes.

Senator McLEAN. Well, do you mean actual allowances? That would not apply at all to the reports of the engineers upon which the final decision was reached.

Mr. MANSON. The original work by the engineers was practically all rejected. The engineers went out, found plants in full operation, and reported that there was no amortization allowable, because the plants were in full operation. Now, it was some time after that, some time in the latter part of 1921 or early in 1922, when they conceived the idea that they could determine amortization by this formula whereby they took the average production for three years and compared it with the war production for the purpose of determining whether a man has excess capacity or not. Now, in a good many instances, as I called the committee's attention in the first place, that application of that method results in this. A taxpayer will get amortization upon the theory that he has not full use of the facilities he installed during the war, notwithstanding the fact that since the war he has increased his capacity. Now, the Firestone people—I did not mention that before—but the Firestone people increased their capacity after the war. The United States Steel Corporation increased its capacity after the war. With the exception of munition makers there are very few of the allowances made for amortization where there was not an actual increase of capacity after the war.

Senator SHORTRIDGE. Mr. Chairman, may I ask a question? I want to get one or two propositions clear in my mind. When was the regulation promulgated?

Mr. GREGG. In 1919. In June sometime, 1919.

Senator SHORTRIDGE. What commissioners approved it?

Mr. GREGG. The original regulation was issued by Mr. Roper. It has been continued in effect to the present day.

Senator SHORTRIDGE. What commissioners severally approved that regulation?

Mr. GREGG. Mr. Roper, Mr. Williams, and Mr. Blair.

Senator SHORTRIDGE. What Secretaries of the Treasury approved it?

Mr. GREGG. Let me see by whom it was issued. It was signed by Mr. Glass. Mr. Glass, Mr. Houston, and Mr. Mellon.

Senator SHORTRIDGE. Very well. Now, there was difference of opinion, and there exists difference of opinion between your department and the committee's representative in respect of that regulation, is that so?

Mr. GREGG. Among other things; yes, sir.

Senator SHORTRIDGE. Yes. Now then, there is difference of opinion as to the application of that rule or regulation, is that so?

Mr. GREGG. Yes, sir.

Senator SHORTRIDGE. In specific cases there is a marked difference of opinion between the two?

Mr. GREGG. Yes.

Senator SHORTRIDGE. You, for the moment, representing one department and the gentleman here, Mr. Manson, we will say, for the moment representing the committee. Is that the situation?

Mr. GREGG. I think that is.

Senator SHORTRIDGE. All right.

Senator JONES of New Mexico. Well, do I understand, Mr. Gregg, that there was any rule laid down in 1919 for the settlement of these cases which the bureau followed?

Mr. GREGG. Well, Senator, I have attempted through the statement to keep that clear. The general proposition that amortization based on reduced value in use is permissible was in the regulation in 1919, and has continued to date. That was the first point that was criticised by counsel for the committee.

Senator JONES of New Mexico. Yes.

Mr. GREGG. The matter of the rules for the application of that—the first complete and detailed statement on it does not appear until this opinion.

Senator JONES of New Mexico. Does not appear until October, 1925?

Mr. GREGG. The first complete and detailed statement of the method of applying it; yes, sir.

Senator JONES of New Mexico. Yes. Now is it not a fact that in applying that formula for the facility in use that you took the peak of the war activity on the one side and the activities in the year 1921 and in the year 1922 principally, and in some cases the year 1923 on the other side?

Mr. GREGG. In some cases, yes.

Senator JONES of New Mexico. And is it not a fact and was it not generally known that the years 1921 and 1922 in manufacturing industries were years of extreme depression?

Mr. GREGG. True in some instances. That is all covered in the opinion, and it is stated that in those industries where 1921 or 1922 were abnormal years they should not be used.

Senator JONES of New Mexico. Well, but they were abnormal years, were they not?

Mr. GREGG. Well, not in all industries; no, sir.

Senator JONES of New Mexico. Not in all industries, that may be true. Nevertheless in the steel business and in many other lines the industry was in a state of extreme depression?

Senator KING. May I say to the Senator that if the opinion which was promulgated in October, 1925, by Mr. Gregg construing the law, and the regulation had been the opinion all through, and had been adhered to, then there would not be so much complaint.

Mr. GREGG. In the years of administering this law we gained a great deal of knowledge and experience, the results of which are embodied in this opinion. Naturally in considering this matter for the years that we have been working on it there have been changes in our procedure, there have been changes in our theories, there have been changes in our methods; but the important point, it seems to me, is that this last opinion, which represents the result of our years of working on it, is in substance agreed to by the committee; and, further, that this opinion is to be used in determining the amortization in all cases which are not finally closed and barred by the statute.

Senator JONES of New Mexico. Now, Mr. Gregg, Mr. Manson this morning mentioned some decision of the solicitor for the department, did he not, regarding this matter, that was handed down some years ago?

Senator COUZENS. In the J. I. Case Threshing Machine Co. case.

Senator JONES of New Mexico. In the J. I. Case Threshing Machine Co. case, and that that opinion was not followed. Now what assurance have we that the section having these cases in hand is going to follow this opinion which you have promulgated?

Mr. GREGG. There are two answers to that, Senator. In the first place, Mr. Manson stated his conclusion that that opinion was not followed even in the case in which it was written. That opinion, as a matter of fact, in some particulars could not be followed. I personally passed upon and approved not six months ago the set-up in the J. I. Case Threshing Machine Co. case, which was not absolutely strictly in accordance with that opinion, although it is in accordance with the latest opinion, because it was not possible, in my opinion, to absolutely follow the other.

Senator JONES of New Mexico. If it were not possible it should have been changed so as to make it possible, and it should have been brought to the attention of somebody there in order that a practical rule could be laid down.

Mr. GREGG. The solicitor and the commissioner were the ones to change it, and we changed it, and this new opinion now represents our view upon it.

Senator JONES of New Mexico. Yes; but four or five years after it.

Mr. GREGG. Not after the issuance of the other opinion, Senator.

Senator JONES of New Mexico. When was it?

Mr. GREGG. 1924.

Senator KING. What opinion did you have then from 1917 and in 1918, 1919, 1920, 1921, 1922, and 1923?

Mr. GREGG. The very general regulation. We had no rules laying down specific methods of applying the regulation.

Now as to whether this opinion will be followed, I have assured the committee, speaking for the Treasury Department, that this opinion will be followed in the closing of all unclosed cases.

Senator JONES of New Mexico. Mr. Gregg, my point that I wanted to bring out was this, that there must be some method by which the public may know whether these things are being done according to a general ruling or not. The thing that was brought out and mentioned by Senator Couzens this morning and contemplated in the questions of Senator Simmons, and I think commented upon by Mr. Manson. Is it not necessary or advisable that there be some means whereby people interested may know whether these rulings are being carried out or not?

Mr. GREGG. It is desirable. The question is whether you want to sacrafice privacy of returns to gain your point. That, of course, would involve a complete sacrifice of privacy of returns.

Senator SHORTRIDGE. I do not know, and hence the question: Is it possible in your opinion to lay down a general rule which will apply to the different facts of various cases? Is it or is it not?

Mr. GREGG. It is not, in my opinion. In the United States Steel case we wrote a 20-page opinion which laid down general rules for the determination of amortization allowances. I have in the office at the present time, I suppose, ten requests for opinion as to the application of that opinion to specific cases. You can not lay down a rule, either by departmental regulations or by opinions, any more than you can in the statute, which will cover every case.

Senator SHORTRIDGE. Well, it was no other than Judge Storey who pointed out the great difficulty of formulating a definition which would fit or apply to all cases.

Mr. GREGG. We have certainly had that same difficulty.

Senator JONES of New Mexico. Well, does it not make it more necessary then that the decision in each case should be available, so that people may know what application is being made of the general statement in the rule?

Senator WATSON. Mr. Manson, the theory upon which our committee reported to this committee was that we should make suggestions as to legislative relief wherein there were defects in the existing law. Do you recommend any legislation on this amortization?

Mr. MANSON. Yes, I submitted one.

Senator COUZENS. May we have it read so we will see what it is?

Mr. MANSON (reading):

Deductions for the amortization of facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government shall not be allowed in cases where the facility acquired was an operating plant when acquired by the taxpayer, in cases where the construction, erection, installation or acquisition of the facility was contracted for prior to April 6, 1917.

nor in cases in which such amortization was not claimed at the time of filing the return of the taxpayer for the years 1918, 1919, 1920 or 1921.

No deduction for the amortization of facilities retained in postwar use by the taxpayer in excess of the difference between the cost of such facility and the cost of replacing such facility on March 3, 1924, shall be allowed, unless such facility consists of a single indivisible unit the size of which exceeds the taxpayer's postwar requirements, when future requirements are duly considered. In case the facility, upon which amortization is claimed, is a single indivisible unit, the size of which exceeds the taxpayer's postwar requirements, when future requirements are duly considered, the amortization allowable shall be the difference between the cost thereof and the March 3, 1924, cost of acquiring a facility of size adequate to meet the taxpayer's postwar requirements.

All allowances of deductions from the income of 1918, 1919, 1920, and/or 1921 for the amortization of war facilities heretofore made in cases in which a final determination of tax has not been made upon the approval of this act and in cases pending before the Board of Tax Appeals shall be redetermined in accordance with the provisions of this section.

Senator WATSON. Inasmuch as amortization expired by limitation some three years ago this could have application, could it not, only to those that have not yet been settled?

Mr. GREGG. Yes, sir.

Senator WATSON. And to those that may be reopened?

Mr. GREGG. Yes, of course. But practically none of them can be reopened.

Senator WATSON. What is your opinion on this proposition?

Mr. GREGG. The first general proposition which appeals to me is this: It is a very bad precedent to set for Congress eight years after the enactment of an act to construe it retroactively for the Treasury Department, and provide for the application of a new rule of construction to cases remaining then unclosed.

Senator JONES of New Mexico. Well, have you not set a precedent in laying down a ruling in June, 1925, which should apply to unclosed cases?

Mr. GREGG. Yes; but it seems to me that the matter of construing a statute enacted by Congress is up, in the first place, to the department, and then to the courts. That ruling of the solicitor is not going to stand. There will be ten points on which it will be taken to the court, and there will probably be five points on which it will be modified.

Senator MCLEAN. And in that rule you are basing it on existing law?

Mr. GREGG. We are basing it on existing law. It seems to me we have to know what the law is, and that the proper thing to do is to leave it as it was enacted and leave the matter of construction up to the department and then the courts.

Senator WATSON. Let me ask you this question: As far as they are comparable, what is the difference between this proposed section or statute and your decision?

Mr. GREGG. From the hasty reading of it I did not get any real differences, except the limitation as to the filing of a claim, and I was coming to that in just a minute.

Senator WATSON. Yes.

Mr. GREGG. Mr. Manson raised this morning, for the first time, the point that there was $40,000,000 of amortization illegally allowed because of the provision of the 1921 act that amortization could be allowed only if claim therefor was filed at the time the return was filed.

Senator SHORTRIDGE. Will you please state that again?

Mr. GREGG. Mr. Manson charged this morning, for the first time, that there had been some $40,000,000 that he had been able to find in a very hurried check of illegal allowances in cases where an allowance was made but no claim was filed at the time of the filing of the return for the years 1919, 1920, and 1921. I disagree with him rather violently as a matter of law, and I would like to point out my reasons to the committee.

Here is the point: The 1918 act provided for the deduction in computing net income of a reasonable allowance for the amortization of war facilities. It contained no limitation whatever about the amortization having been claimed at the time the return was filed.

When the 1921 law was on the floor of the Senate, Senator King, when the amortization section was read, inquired why that section, which was a war measure, was contained in a 1921, a postwar act. It was pointed out to him that there were cases where the amortization of facilities acquired during the war would be spread as a deduction over years affected by the 1921 act, years as late as 1921. Senator King made the point that amortization in those late years should not be allowed unless it was claimed at the time of filing the return.

Now as a result there was put in the statute this provision that "in computing net income there shall be allowed as deductions a reasonable allowance for amortization (if claim therefor was made at the time of filing return for the taxable years 1918, 1919, 1920 or 1921.)"

The heading of that deduction section is this:

> That in computing the net income of the corporation subject to the tax imposed by section 230 there shall be allowed as deductions, a reasonable allowance for amortization (if claim was made at the time of filing the return for the taxable years 1918, 1919, 1920, or 1921.)

Referring to section 230 it says,

> In lieu of the tax imposed by section 230 of the revenue act of 1918 there shall be levied a tax for the calendar year 1921 of 10 per cent. For each calendar year thereafter 12 per cent.

In other words, the deduction to which the limitation applies—I am quoting the language of the act—is a deduction in computing the net income of a corporation subject to the tax imposed by section 230. Section 230 imposed a tax for the calendar year 1921 and for subsequent years. It seems to me perfectly plain that that section has no application to the tax under the 1928 act. That section has been observed strictly in allowing deductions for amortization under the act of 1921. It has never been observed, and I think as a matter of construction the action was proper—it has never been observed in determining the deduction under the revenue act of 1918.

That is the last point.

Mr. MANSON. Now right on that point there, I wish to say that the Board of Tax Appeals in Stauffer Chemical Co., Docket No. 1429, decided October 12, 1925, holds that the claim must have been taken with the return of 1918 to get a 1918 deduction, and in 1919 to get a 1919 deduction, and so on.

Mr. GREGG. That is perfectly true. The board I think in that case made the mistake of deciding a case on a point which—I had the

record looked up to make sure—was not even urged before it—with the result that we have gone back at the board for a reconsideration of that case. It seems to me that the statute is perfectly plain and obvious and that limitation only applies under the 1921 act. That is certainly the fair construction. I can not conceive of Congress limiting the deduction, for example, in a case where the return was filed, say for the fiscal year 1918, before the passage of the 1918 act, to cases where they claimed the amortization on the return although amortization was not provided for until the 1918 act.

Senator REED, of Pennsylvania. Did the board base its decision on the ground of the parentheses in the 1921 act?

Mr. GREGG. Yes. The point was not argued before them. As soon as the decision was handed down we immediately held up all amortization allowances involving this point until we could get a reconsideration of that decision. I think that to everyone who has really gone into the question, or even just from the bare statement that I have made of it, the fallacy of the reasoning of the opinion is apparent.

Senator JONES, of New Mexico. Let me ask you as a matter of opinion. If they claimed amortization in the reduction of taxes of one year could they get an allowance of more than the tax for that year? Or would they have to spread it over several years?

Mr. GREGG. They would have to spread it over several years. There is one other matter, the matter of publicity of rulings.

Senator JONES, of New Mexico. Suppose a concern had gone out of business, and the tax was not sufficient to cover amortization, would you make a refund?

Mr. GREGG. No, sir; you see the amortization allowance is spread and allowed as an offset against the war income from the facility. That is the general principle. If they went out of business of course it could not be spread over the year after they went out of business, because of the fact that they could not have any income from the war facility.

Senator JONES, of New Mexico. Then if the taxes were not enough to take care of the amortization they would be out of luck, would they not?

Mr. GREGG. They would be out of luck. They just would not get the full benefit of that deduction.

Senator SHORTRIDGE. Before you leave that. In other words, under the law of 1918 there was no provision requiring claim to be made?

Mr. GREGG. No, sir.

Senator SHORTRIDGE. That requirement first appearing in the law of 1921?

Mr. GREGG. Yes, sir; and provided that that limitation should apply only in computing the tax for the years 1921 and subsequent years. On the matter of publicity of rulings I would like to give just a little history on that. Originally the bureau published none of its rulings. Through the year 1919 there were no rulings published. The rulings were considered as confidential, and bulletins were issued only for the information of the employees of the bureau. At the end of 1919—I am speaking from memory, I am not quite sure of the date—about that time it was decided to make the rulings public. From then on those rulings which in the opinion of the officials of

the department had any general application or were of any general interest were published in a weekly bulletin. That practice has continued to the present day.

Some of the rulings of the department which had been issued prior to the adoption of this policy of publishing the rulings have never as a matter of fact been published, although employees have taken all of those old rulings and gone over them to determine which of them should be published.

From that time to this we have always published all of those rulings which, in the opinion of the officials of the department, had any general application, or the facts of which could be deleted to such an extent that the identity of the taxpayer could not be determined from reading the opinion. There are about 10 volumes of them published now containing the rulings of the department.

The most important precedents for the future, of course, are the rulings of the Board of Tax Appeals. They are published in the same way that decisions of the courts are published.

It is not possible, in my opinion, to publish the grounds of the settlement of every case.

Just as a matter of interest and I think this is quite significant as showing something of the size of our problem. I knew that the A-2 letter in the United States Steel case had been issued in the last week. I phoned up this morning to find out about that. Now that letter in the steel company case contains no reasons. It just contains the adjustments which the department has made on the returns of the taxpayer for the years say 1917, 1918, and 1919. In other words, it is mostly mathematical. It is a mathematical computation, practically, of the adjustments made by the department on the basis of their audit, without giving the reasons. That A-2 letter was 3,000 pages, with 250 pages of exhibits, and that does not include the amortization report. I am referring to that just to show you the proportions that a single case may assume.

An interesting side light on it is that the field agent who made the assessment—Mr. Nash gave me this information this morning on the phone—who was on a salary of $3,300, resigned on December 31 to take a position, having no connection with taxes, with a company, in no wise connected with the United States Steel concern, at a salary of $10,000 a year. You can imagine the difficulty which we will now have in proceeding with that case after the loss of the man who had been working on it all that time.

That case illustrates to my mind better than almost any other case the number of points that can arise in a given case, and shows very clearly the impossibility of setting forth in each case a complete statement—an opinion really is what it amounts to—on every point involved. It is just naturally impossible.

Senator SHORTRIDGE. How much of a document was it?

Mr. GREGG. It was the regular size letterhead paper. 3,000 pages, in the A-2 letter.

Senator SHORTRIDGE. Three thousand pages?

Mr. GREGG. Three thousand pages, and 250 pages of exhibits. That was without the reasons.

Senator SHORTRIDGE. Did it give the principles of law laid down?

Mr. GREGG. Presumably it involved only the application of the law to that particular case, as well as the precedents and rulings of the bureau.

Senator JONES of New Mexico. How many different questions were involved?

Mr. GREGG. I should hate to guess at it, Senator.

Senator JONES of New Mexico. Well, just give us the nature of the different questions that would call for such a voluminous report.

Mr. GREGG. Every type of question. Of course, the first question is to determine the invested capital of the United States Steel Corporation and, I think, its 175 subsidiaries. That is, the value of all the property now owned by the United States Steel Corporation, as of the time it was paid in to the concern, or to the various subsidiaries. Also the computation of the income of those companies, from the date of their organization, to get the earned surplus of the company for the determination of invested capital, as well as a determination of the statutory net income of those companies for the years under review.

Senator REED of Pennsylvania. What were the years under review?

Mr. GREGG. I think that they were the years 1917, 1918, and 1919.

Senator REED of Pennsylvania. This arose under the excess-profits tax?

Mr. GREGG. Yes, under the excess-profits tax.

Senator REED of Pennsylvania. No such computation or report is necessary under the present tax?

Mr. GREGG. Oh, no, sir.

Senator JONES of New Mexico. Mr. Manson, did you make any special investigation of the method of determining invested capital down at the bureau?

Mr. MANSON. Oh, yes.

Mr. GREGG. Before we get off this publicity may I continue just a minute?

Senator Jones of New Mexico. Yes.

Mr. GREGG. I think it is interesting in connection with the criticism of the department for not publishing more of its rulings to notice that Great Britain with an experience of half a century in administering income tax has never even published its regulations. It has not published a single ruling. It has a confidential volume of rulings, one volume, confidential, for its own employees, but it has never issued either any regulation or published any rulings.

We have attempted to publish all rulings that have any general application. On the outside of the publishing bulletin there are instructions to employees of the bureau that no unpublished ruling shall be used as a precedent in the disposal of any other case. That has been in effect approximately a year now. Of course prior to the issuance of those instructions unpublished rulings may have been followed, but we can not go back and refer to those cases. At the present time those instructions are on the bulletin. We do everything possible to see that those instructions are complied with.

Senator REED of Pennsylvania. How long has Great Britain had an income tax?

Mr. GREGG. Since 1842. Continuously since then. Sporadically before that.

Senator REED of Pennsylvania. There have been a great many judicial decisions, have there not?

Mr. GREGG. A great many. But much fewer than you would think. That reminds me of something I would like to bring out. I have expressed time and again the great difficulty of these questions, how close they are—the fact that questions can be decided either way. And illustrative of that I would like to point out that of the last 15 decisions of the Supreme Court of the United States on income tax questions nine have been handed down by a divided court. Nine cases out of the last 15.

Senator SHORTRIDGE. Right on that point, I think it is well for the committee to bear in mind that a great complaint to-day in America grows out of the multitude of opinions, and as to opinions of our courts of last resort being published. The publishing of cases which involve no new principle of law is discouraged. Many, many opinions of many of the States are not published. In many of the States the judges select and cause to be published those opinions which they think announce new principles or set forth old principles in some better style or fashion.

Mr. MANSON. I made the suggestion this morning at the time we adjourned concerning the publishing of these opinions, and I do not know as it received any attention, but I appreciate the difficulty in publishing of opinions. But I believe that it is important that every opinion laying down a rule not theretofore published, and laying down a rule in conflict with an opinion published, or modifying an opinion published, should be published, and should be published promptly.

Senator SHORTRIDGE. Personally I agree with you.

Mr. GREGG. Oh, yes.

Senator REED of Pennsylvania. You agree with that, do you not, Mr. Gregg?

Mr. GREGG. Oh, yes.

Mr. MANSON. And I have had my attention called to cases where a determination was made in accordance with an unpublished ruling, and a published ruling published at practically the same time held that that determination could not be made. Now I am very strongly of the opinion that no case should be considered as finally disposed of unless there is a published ruling at least within 30 days after that case is disposed of, which states the principle.

Senator SHORTRIDGE. I am very much interested in this phase of the matter. During the war days, under certain statutes as interpreted, men were prosecuted for violating rules issued by the War Department. I know of men who were indicted and prosecuted in San Francisco for the violation of certain orders issued when the very court, when the case came on to be tried, did not have the order. They proceeded upon the theory that these orders had the effect of law, and that the citizen was presumed to know them as a matter of public policy. Wherefore it was alleged he had violated the law—which he had never seen, a copy of the order never having been published in California. Well, you can see that that suggested to some minds a great injustice. I think, Mr. Chairman, that where

a ruling announces some new principle or departs from some former ruling——

Mr. MANSON (interposing). Or elaborates upon a former ruling.

Senator SHORTRIDGE. Yes; stating or elaborating it, it should be published so that the taxpayer may know it.

The CHAIRMAN. Now that we have all agreed upon it I think that should be done.

Senator WADSWORTH. Is that being done?

Mr. MANSON. I checked it up, and of the formal rulings only 15½ per cent have been published.

Mr. GREGG. That is all the way back.

Senator WADSWORTH. What is the situation to-day? What percentage, let us say, of the formal rulings?

Mr. MANSON. Fifteen and one-half per cent.

Senator WADSWORTH. No; that is not answering my question. What is the percentage to-day, for example, or during the last year, of the formal rulings that have been published. I do not care about 1918, 1919, or 1917. What are you doing to-day?

Mr. GREGG. I do not know, sir. Every ruling that lays down any new matter or principle or reverses an old ruling is published. There may be occasional slips, but those are the orders, those are the instructions. For example, in my own office, Senator Wadsworth, when an opinion goes out of the office it has on it a slip that it will be published within a given time, 10 days I think it is, unless the administrative official to whom it is addressed presents objections to its publication within that period. That is because he may disagree with it and want us to reconsider it. All of those decisions which have any general application are published. There are some cases where you can not delete the facts sufficiently to publish the opinion. They are not published. There are cases where we are repeating a ruling which is published, restating it, or applying a ruling which is published. If there is no new principle in it we do not publish it. But any ruling laying down a new principle is published.

Mr. MANSON. I call attention to this fact, that a large part of the rulings actually being followed, and when I say rulings I mean the practice of the department, the principles that they are following, have never been reduced to writing. That are not covered by any ruling published or unpublished.

Mr. GREGG. What, for instance?

Mr. MANSON. Why, you have never had a written rule on the whole subject of amortization up until the time you handed down your opinion a few months ago.

Mr. GREGG. I understand we are not discussing past history.

Mr. MANSON. I do not know what you are doing right at this present day.

Senator WADSWORTH. Well, it is important to know what the condition is at the present day, even more than five years ago.

Mr. MANSON. Well, I was talking about conditions up to the 1st of June.

Senator SHORTRIDGE. What is the law now, the practice now?

Mr. GREGG. The practice is to publish anything having any general application or any general interest. As I say, our bulletin has for a year contained the express instructions on it that unpublished rulings are not to be used as precedents.

Senator COUZENS. What is the kind of a ruling, an unpublished ruling, that might not be used as a precedent, I mean a typical case, so we can get an idea to what extent those special cases may be used?

Mr. GREGG. I will illustrate that in this way. We used to have an appeal to the office of the Solicitor from a proposed assessment of the Income Tax Unit. On those appeals no interest ran until they were finally decided. We were getting appeals in the office at the rate of about 300 a week in those cases. Half of those cases were covered by published rulings, the appeal in many cases being taken entirely for the purpose of delay, since no interest was being charged in the meantime. So, if a case is clearly governed by a published ruling the opinion merely recites the fact: "This case is governed by law opinion so and so, and the claim should be rejected." There is no necessity for publishing that, and it is not published. If, however, it involves a new principle and an opinion is written on it, it is published.

Mr. MANSON. I do not believe that even to-day—I am guessing on what has occurred since the 1st of June, but even to-day I do not believe that you have reduced to writing any comprehensive statement of the principles you apply to special assessments. You have got a few published rulings on the subject, but nine-tenths of the questions that are being passed on there right along have never been reduced to writing, unless you have done it since the 1st of June.

Mr. GREGG. There have been none published since the 1st of June. The general opinion on special assessment is published.

Mr. MANSON. Well, it does not cover one-tenth of the questions that are involved on the subject and that you are passing on regularly, that is that are being passed on regularly by the auditors doing that work.

Senator MCLEAN. Nine-tenths of the cases, but does it not cover more than one-tenth of the principles?

Mr. MANSON. No.

Senator SHORTRIDGE. I remarked a moment ago that in many of the States—I have in mind the Supreme Court of California—the court does not publish all of its opinions. They select those which they think are important as laying down some, perhaps, new rule, or a peculiar application of some old principle of law. Of course all of them are open, but they do not publish them all. They publish a memorandum of cases the court has decided, in this fashion: "Smith *v.* Jones, affirmed, on authority of such and such cases."

Senator COUZENS. I may say, Senator, that our committee, or at least the representatives of our committee would not object to that, if the same condition existed with respect to those decisions as exists with respect to the courts. The fact is that, as you stated, they are open for investigation for any one that wants to go in. It is immaterial, so far as I see, whether they publish the rulings, if the rulings are open for taxpayers to investigate at will.

Senator SHORTRIDGE. Well, I agree with you that they should know what the rulings are in order that they may govern themselves accordingly.

Senator COUZENS. I want to ask Mr. Manson at this point if there are not decisions of vital importance which have at the end of the decision this verbiage: "This case is not to be used as a precedent in other cases"?

Mr. MANSON. My attention has been called to such rulings, yes.

Mr. GREGG. Will you cite the cases, please? There is one that I wrote, I am aware of that one.

Mr. MANSON. I can not recall offhand all of them; in fact I have seen so many of them that I can not recall offhand what they were.

Senator COUZENS. We will look it up for you.

Senator SHORTRIDGE. What was the reason for making such a notation?

Mr. GREGG. I remember one case where I made such a notation myself on the bottom of the opinion. I remember one case where the opinion of the solicitor had that on it. I can cite you several cases where I have transmitted to the Income Tax Unit opinions of the Board of Tax Appeals and opinions of of the court in which we have acquiesced or have taken no appeal, and in which I have said the same thing: "This case is not to be considered as a precedent."

Senator SHORTRIDGE. Why?

Mr. GREGG. Cases are passed on by auditors in the Income Tax Unit. If I were perfectly sure that the decision were to be properly applied by lawyers it would be one matter, but to have it applied by men who are not lawyers, I am afraid of a possible misapplication of the opinion, and on occasion have put some such language either in the opinion or on the memorandum transmitting it. I sent a decision of the Board of Tax Appeals in a case, in which we acquiesced, to the Income Tax Unit within the last two weeks, in which I put such language in the memorandum. Some of the cases are most difficult to apply, and they have very limited application. We just fear that they would be extended beyond their application if applied as precedents by the Income Tax Unit.

Senator REED of Pennsylvania. Mr. Manson, we have got your point. I want to ask you this. Suppose you were the entire Congress yourself, what would you do about it?

Mr. MANSON. About what?

Senator REED of Pennsylvania. This matter of publication of rulings.

Mr. MANSON. This matter of publication of rulings. I would provide in the act—mind you, I have given this most mature consideration as to just what to do about it because I know what their problem is down there. I would provide in the act that no determination of any tax should be final, notwithstanding the statute of limitations, unless the principles involved in that determination were stated in a ruling published within 30 days after the determination made.

Senator REED of Pennsylvania. That would upset 60,000,000 cases.

Mr. MANSON. No; I do not propose to upset anything. I say that hereafter no determination made shall be final. I am not trying to go back and upset anything. Now, if that determination is made in accordance with some ruling that has been published there is no occasion for publishing it. If there is any new principle involved in it or any modification of an old principle that has not been stated it must be published.

Senator REED of Pennsylvania. But that is penalizing the taxpayer.

Mr. MANSON. I know, but you will find a great body of precedent that every auditor in the bureau is following, under some chief, that has never been reduced to writing at all. Now that is just as important and just as vital to the taxpayer, that he should know that, without hiring somebody that is on the inside, as that he should know the rules that are handed down in the cases that are appealed.

Senator REED of Pennsylvania. You are not answering my question at all as to what the legislature can do about it, except that you say that you would abolish the finality of settlements where the bureau did not, after the settlement, publish the principle of the ruling.

Mr. MANSON. I mean either after or before.

Senator REED of Pennsylvania. As I understand the thought of people generally on these income-tax cases they resent the keeping of the cases open so many years and the slowness of the bureau in settling them, and the lack of finality under the present law more than they even resent the injustice of the decisions.

Mr. MANSON. What I have in mind, Senator, is this, that no advantage under this law should finally accrue to any taxpayer unless the principles under which that accrues are published, so that other taxpayers may avail themselves of that same privilege.

Senator SHORTRIDGE. Would you not be willing to proceed just as an appellate court does, publish just those decisions which the court thinks are necessary for the profession, and make a notation or report merely of those that are not thus necessary?

Mr. MANSON. Well, I have tried in all the discussions, both before this committee and the other committee, to keep away from any personal attack, but I do want to say this, that I have found strong evidence of a policy to bargain, in which the principles that should have governed the determination of that case have been absolutely ignored. Now I do not say that that was not honestly done. I do not mean to impugn the motives of the officers who made those settlements. But I do say that I believe that if you simply leave it to the bureau to determine what they will publish and what they will not publish, that they just will not publish the kind of cases that Mr. Gregg referred to, where they just figure that "We will settle that case on its special facts, and we will not use that as a precedent in any other case." I believe that with six or seven million taxpayers to deal with, we have got to deal with them as a matter of principle, and that you are never going to get the work current, and you are never going to keep it current with a reasonable force unless you deal with these questions as a matter of principle instead of as a matter of bargain.

Senator McLEAN. Will not a great many of them come out in the decisions of the Board of Tax Appeals?

Senator COUZENS. It is only when the taxpayers complain.

Mr. MANSON. It is only when the taxpayers complain and the cases are decided.

Senator McLEAN. Well, there are a great many decided.

Mr. MANSON. That may be true. But you take on the subject of special assessment, when he gets a special assessment he is satisfied. Now another taxpayer does not know the principles that were

applied to that particular case. He might have claimed a special assessment on a particular ground, but did not until some tax expert comes along and tells him about it. I think that it is of vital importance that you destroy the monopoly on information possessed by tax experts. You are placing an artificial premium upon the inside information of a few men, which makes their services so valuable to the taxpayer that the Government can not retain them in this service and pay a salary which is commensurate with a salary payable for other service.

The CHAIRMAN. What objection have you if the bureau carries out the system and plans as recited by Mr. Gregg now touching future publication?

Mr. MANSON. Well now, for instance, Mr. Bright, when he was deputy commissioner, discussed this matter with me, and Mr. Bright told me that it was a matter of policy not to reduce to writing the instructions to auditors. Now he claimed that it should not be done. Now I believe that it is of vital importance that it should be done. It may be that some auditor or some engineer will misconstrue a rule, but it is certainly a whole lot better that there be a rule there even if it is going to be misconstrued occasionally than that there be no rule.

Now I do not mean to say that you could set up beforehand all the rules that were going to be applied to taxes, but I do say that with the experience that you have had, and with practically every question that can ever be raised before the bureau, that you can reduce your common practices to writing, and you can publish the formal rulings that you make.

Now Mr. Gregg is only talking about formal rulings. What I deem of perhaps more importance than that even is the practice that never passes into a ruling.

Mr. GREGG. The matter of publishing every ruling made——

Mr. MANSON (interposing). I do not claim that that is necessary.

Mr. GREGG. Well, on your proposal for legislation I would like to submit this. The department is now closing cases on the basis of 40,000 a week average. Those cases may involve a great many points. One of them may be a case like the United States Steel, where the A-2 letter is 3,000 pages. A publication of the principles of the points involved in every case, would be practically an impossible task.

Senator MCLEAN. That is similar, for instance, to this. You have got a statute against fraud. If you undertake to set up and anticipate every and all combinations of facts that would constitute a fraud you would have quite a contract. It seems to me that you are running into about the same difficulty when you ask that these auditors that are called upon to interpret the law shall have printed a system of rules which will anticipate every combination of facts where there are, however, no two cases alike.

Mr. MANSON. But, mind you, you have thousands of cases alike. I think that the peculiarities of particular cases have been greatly exaggerated. Now as far as a few subjects are concerned here we have gone through them with a fine tooth comb, and I know that the principles of those subjects could be reduced to writing and briefly

stated, and that by doing that you would eliminate a large part of the work that is now being done.

Mr. GREGG. The matters of construction which have general application, and which apply to a great many cases, are contained in the present regulations signed by the commissioner, and approved by the Secretary. They are supposed to have, as nearly as possible, everything of general application. Rulings, then, in specific cases where they set up a principle, are published by the bureau. It seems to me that that is as far as it is possible to go in getting publicity of precedents.

Mr. MANSON. I know that your published regulations are so general in their terms that they add very little to the reading of the law itself.

Senator KING. Mr. Chairman, I suggest that Mr. Manson and Mr. Gregg during the interim have a conference and see if they can work out any suggestion that may meet the situation.

The CHAIRMAN. Mr. Manson tells me that it will not take him so very long if we let him alone, and if we can get through to-morrow morning by 12 o'clock I do not see that there is an necessity of holding a night session.

Senator MCLEAN. Are these engineers that are employed to make these investigations changed with changing administrations to any extent?

Mr. Gregg. No, they are retained right along.

The CHAIRMAN. We will now take an adjournment to 10 o'clock to-morrow morning.

(Whereupon, at 5 o'clock p. m., an adjournment was taken until 10 o'clock a. m. of the following day, Wednesday, January 13, 1926.)

REVENUE ACT OF 1926

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

WEDNESDAY, JANUARY 13, 1926

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

The committee met, pursuant to adjournment, at 10 o'clock a. m., in room 312, Senate Office Building, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Reed of Pennsylvania, Ernst, Stanfield, Wadsworth, Shortridge, Simmons, Jones of New Mexico, Gerry, King, Harrison, Bayard, and George.

Present also: Senators Couzens, chairman of the Select Committee Investigating Bureau of Internal Revenue, and Mr. L. C. Manson, counsel to that special committee.

The CHAIRMAN. If the committee will come to order we will proceed. Mr. Manson, you desire now to take up the question of depletion, as I understand it.

Mr. MANSON. I do; yes, sir.

The CHAIRMAN. You may proceed.

STATEMENT OF L. C. MANSON, ESQ., COUNSEL FOR THE SENATE SELECT COMMITTEE INVESTIGATING BUREAU OF INTERNAL REVENUE—Continued

Mr. MANSON. Depletion is that deduction from operating income provided to cover capital consumed in the operation of a mine or an oil or a gas well, forest, or natural deposits.

The method followed by the bureau of arriving at the depletion deduction is to divide the value to be depleted by the estimated number of units in the mine or in the oil or gas property. What I mean by that is to estimate the number of tons of ore, for instance, in a mine and divide the value to be depleted by that estimated tonnage of ore, which gives a depletion unit per ton. For instance, if they estimate a billion tons of ore and have a value of $500,000 to deplete, the unit of depletion would be 50 cents per ton.

The law provides for three classes of values to be depleted. In the first place, in the case of property purchased since the 1st of March, 1913, the value to be depleted is the cost. Such cases give rise to very little difficulty. In the case of property owned by the taxpayer on March 1, 1913, the value to be depleted is the cost or March 1, 1913, value, whichever is the higher. As a matter of practice the March 1, 1913, value is the basis of depletion. In that event an appraisal of the value of the mine or oil or gas property, whatever it is that is to be depleted, is necessary.

A third class of depletion is what is known as discovery depletion. Discovery depletion applies to property where the mine or oil or gas well was discovered since March 1, 1913.

In the case of discovery depletion the value to be depleted is placed upon the property after discovery. There is some considerable difference of opinion as to the economic merit of discovery depletion. I do not deem it my function to discuss that economic problem, but I do deem it proper to point out the facts involved and the elements that are involved in it.

In the allowance of discovery depletion on mines, oil and gas wells the increment in value which takes place subsequent to March 1, 1913, by reason of the discovery of the mine, oil, or gas well escapes taxation. That is the only case under the income-tax law where increment in value since March 1, 1913, escapes taxation.

Senator SHORTRIDGE. Does not that depend upon whether in the meantime the mine has been worked? Do you draw a distinction between an oil well and a gold mine?

Mr. MANSON. There is no distinction in the law between an oil well and a gold mine. The point I make is this: That without entering into any discussion of the propriety of this allowance, which I do not deem to be my function, I point out merely the fact that in the case of discovery depletion the increment in value which takes place subsequent to the 1st of March, 1913, in property is exempted from tax, and that is the only case under the law where realized increment in value does take place.

Senator SHORTRIDGE. Well, perhaps I will have something to say about that some time. But may I say, Mr. Chairman, any one who knows anything about a gold mine or has the slightest speaking acquaintance with an oil well knows that there is a great difference between the two, and when we talk about the increment or increase of a gold mine by virtue of discovery, it is a vastly different proposition from increase of increment in an oil well.

Mr. MANSON. The statute which provides for discovery value as it now stands provides that discovery value shall not be allowed; that is, discovery depletion shall not be allowed where the property falls within an area which was a proven area at the date of purchase or acquisition by the taxpayer.

Senator CURTIS. What section is that?

Mr. MANSON. That is section 214. The House has made some amendment to that section in the bill that is now before this committee. It is my judgment that the House amendment makes no material difference in the law. It cuts out the allowance of discovery values on proven areas unless the taxpayer enters into an agreement with the adjoining owner whereby he shares the cost of bringing in the discovered well.

Inasmuch as the statute does not fix any relative amount that he shall pay, under the provisions of the proposed bill an adjoining owner can preserve his discovery rights by the payment of one dollar to an adjoining owner who is drilling for oil.

Without going into a discussion of this particular subject, I wish to call the committee's attention to the fact that in the report of the investigating committee the committee has shown that it is possible and the practice to blanket whole pools with discovery

areas. I have in mind one case now where there were 14 discoveries on a 160-acre area.

Senator SHORTRIDGE. What do you mean by that, 14 discoveries on a 160-acre area? I understand that one of the witnesses here attempted to show some mistake in law or fact on the part of the department—that is, the way in which they have administered the law—and I want to know what you mean by 14 discoveries in 160 acres.

Mr. MANSON. You will find opposite page 40 three diagrams, the second of these diagrams representing a case where 14 discovery values are allowed on a 160-acre area. I merely call attention to that case. It is fully explained. It was owned by a man named Foster.

Senator CURTIS. Was not that under the old law?

Mr. MANSON. That, of course, is not under this new bill.

Senator CURTIS. And it was not under the act of 1924 either, was it?

Mr. MANSON. Well, the act of 1924 limits the amount of discovery depletion which may be taken but does not change the discovery areas which may be allowed.

Senator CURTIS. Now, about this 160 acres; have you any evidence, or was there any showing made, as to how those separate discoveries were made? Were there separate and distinct leases?

Mr. MANSON. No; this was all one lease.

Senator CURTIS. Of course, Foster had a blanket lease over the entire Osage Reservation.

Mr. MANSON. If you will follow the sketch I will explain it to you. There were five sands there. You see he brought in his discovery wells near the four corners of the 160 acres. In that way he could bring in four discoveries on each sand. That made the 20. That would make 20 if he had gotten a discovery in each sand. He could, in other words, get under the law 20 discoveries on that 160 acres.

Senator CURTIS. On one lease?

Mr. MANSON. On one lease.

Senator CURTIS. Under the existing law?

Mr. MANSON. Under the existing law. Now, I have explained in detail on page 41 just how he got that.

Senator CURTIS. It is one lease and it seems to me that a man would be entitled to discover under one lease on one section for every sand that he might have to go to, because anybody that has been interested financially in oil wells knows what the experience is. You discover oil in your first sand. It soon runs to nothing. Then you have to take a chance as to whether you will go to the lower sand or not. You may strike oil on the lower sand and you may not. You may go to the lower sand and get a dry hole and still go to another lower sand 20 miles away. I have known wells in my State to go down 40 feet and strike a 40-barrel well and another to go down a thousand feet and strike oil, and then you might strike a dry hole. It costs about $35,000 to go to the lower sand and it costs about $1,500 or $1,800 to go to the first sand.

The CHAIRMAN. Mr. Manson, can you tell me how many dry holes were in this section?

Mr. MANSON. I do not think there were any. This diagram that I have included here shows the location of each well. I did discover other wells, but the other wells and the explanation of the diagram are contained on page 41.

I do not know that it is necessary for me to go all through that. I merely call attention to the fact that it is due to the fact that the discoverly wells were brought in at the corners of the 160-acre area, and under the regulation which defines a proven area as a square 160 acres, a well brought in at the corner of 160 acres would only prove approximately 40 acres. In that way you could get four discoveries on each 160 acres.

There were 5 sands involved here, which would permit you to bring in 20 discoveries. In this particular case this man claimed only 14.

The committee's report brings out the fact that a very small percentage of the discovery values allowed for depletion purposes are upon what might be called strictly wild cat territory. That is, a very small percentage of the discovery depletion allowed arises out of discovery of new oil pools.

Whether or not Congress desires to exempt from taxation the income or a large part of the income derived from oil wells brought in on territory where the finding of oil is reasonably certain, is a matter of policy for Congress to determine.

Senator SHORTRIDGE. It must be borne in mind, Mr. Chairman, that in a so-called proven area one well may be very productive when sunk to a depth, say, of 2,000 feet, while another well within 40 feet of it may be entirely dry. The oil does not lie in a great pool as a lake, but it runs in what are like creeks and rivulets, illustrated by the fingers of the hand. So that one well may be productive and the other entirely dry.

Mr. MANSON. Now, on the matter of valuation of oil property for purposes of discovery depletion, when an oil well is brought in on an area the value given for discovery depletion purposes is based not upon the estimated quantity of oil which will be recovered from that well, but upon the estimated quantity of oil which lies within the area owned or under lease by the taxpayer and within a square 160 acres of which the discovery well is the center. In that way if a lessee has a lease on 160 acres and brings in his well in the exact center of the 160 acres, he gets a valuation for depletion purposes which is based upon the estimated quantity of oil under the 160-acre area. If he brought in his well directly on the corner of his lease he would get a valuation based upon the amount of oil under 40 acres.

The CHAIRMAN. That is generally the result, is it not, of having those wells sunk near the corner or near the line of the adjoining property?

Mr. MANSON. Yes. As a matter of practice the ordinary operator will drill as close to his boundary line as possible in order to get as much oil from his neighbor as he can.

Senator CURTIS. That is the point in my part of the country.

The CHAIRMAN. To get as much from his neighbor as possible or if the other fellow has drilled first to stop him from getting as much of his oil as he can.

Mr. MANSON. He wants to get as much of the other fellow's as he can before the other fellow gets there.

Senator SHORTRIDGE. What is the point of all this?

The CHAIRMAN. This will lead up to the question of depletion, Senator. I rather think this is important.

Senator SHORTRIDGE. Very well. I just wanted to know what he was trying to arrive at.

Senator JONES of New Mexico. Is it not a fact, Mr. Manson, that as a practical application of the existing law everybody gets discovery depletion?

Mr. MANSON. I can not say that they all do, but I can see under the existing law where they all can, and I do not think very much of it is overlooked. At least it is my observation in the cases that we have examined that there is not any of it overlooked.

Senator JONES of New Mexico. It operates this way: Before you begin to drill on a geological structure all that land is taken up by somebody. It may be that there is some little part of it that is held out and not included in a lease to the fellow who is drilling or to some other fellow who has a lease there expecting to benefit by the drilling of the man who actually puts up the rig. I think as a matter of practical operation everybody gets discovery depletion under the existing law.

Mr. MANSON. Well, out of 18,671 cases of discovery depletion there were only 35 of them where it went to the discoverer of a new oil pool. The balance of them were discovery depletions allowed upon known oil pools.

The CHAIRMAN. Let me get a better understanding of your position. Take Signal Hill at Long Beach, for instance. Those wells there are all thick, about 20 feet apart. Each one of those wells certainly has not a discovery depletion.

Senator KING. I think they did.

The CHAIRMAN. No; I am quite sure they did not.

Mr. MANSON. Let me explain how that arises. For instance, you have a 160-acre area. It is going to take a great many wells to get the oil out of that 160 acres, but you get a valuation. Suppose you put your first well down in the center of the area. You may have to have a well for every 5 acres, in which event you would have to have about 30 or 32 wells on that 160 acres to recover the oil. When you get your first well down you claim your discovery value on the 160-acre area as the value attached to your first well, although it may take 31 more wells to recover that oil. In fixing that valuation which is attached to the first well they estimate the amount of oil which will be recovered from the 160-acre area. So that, as a matter of fact, the other wells that you put down are merely instruments or agencies for the purpose of recoverins the valuation which has been given to you in connection with the discovery well.

The CHAIRMAN. To get the oil out quicker?

Mr. MANSON. Yes.

Senator CURTIS. There is not the chance for dry holes in the other wells.

Mr. MANSON. Yes, there is; and I pointed out in connection with the values made that no proper consideration has been given. Of course, that is a matter of valuation which is aside from the subject

which we are discussing now; but in connection with the oil industry the dry holes will average about 20 per cent. I think nineteen and a fraction per cent of all wells drilled are dry holes.

The CHAIRMAN. That is within a proven district?

Mr. MANSON. Yes. It is what we might call a place where they found oil.

The CHAIRMAN. That is what I mean by "proven district." It is a producing district.

Mr. MANSON. One criticism that we have made of their oil valuations is the fact that they have given no consideration at all to that 20 per cent dry holes in estimating the amount of oil likely to be recovered from this 160-acre area.

Senator SHORTRIDGE. What oil-producing section have you in mind when you make that statement?

Mr. MANSON. All of them.

Senator REED of Pennsylvania. Mr. Manson, if I put down a well in the middle of my 160-acre tract, then I am allowed discovery for the whole 160 acres, and we will say that after estimating the quantity of oil to be derived from that tract and the value of it we arrive at a depletion allowance of $1 a barrel. Under the present regulations, no matter how many wells I drill in that 160-acre tract, I am entitled to deduct for depletion $1 per barrel from the product of all of those wells. Is that the situation?

Mr. MANSON. That is right.

Senator REED of Pennsylvania. Then, on this Foster tract that you show here that is peppered with oil wells, the discoveries that were claimed allowed him not only to deduct depletion on those discovery wells, but on all the other wells shown on that tract?

Mr. MANSON. Yes.

The CHAIRMAN. Would not that have been the same with the individuals who sunk those wells?

Mr. MANSON. Surely.

The CHAIRMAN. They would have been allowed $1 per barrel, as suggested by Senator Reed?

Mr. MANSON. Yes.

Senator REED of Pennsylvania. Suppose Foster's neighbor had sunk a well right along his property line, and had gotten himself discovery allowed for a part of his tract. Would that have had any effect at all on Foster's right?

Mr. MANSON. Yes. Foster had 160 acres. We will assume that Foster's neighbor put down a well 10 feet each of Foster's east line and at about the middle of the north and south line. That would prove the east 80 of Foster's land with the exception of the west 10 feet of the east 80.

Senator REED of Pennsylvania. And any well that Foster might sink in that east 80, minus 10 feet, would entitle him to the same depletion allowance that his neighbor had determined?

Mr. MANSON. No. If that was the impression I left by my former statement, I want to clear it up.

The CHAIRMAN. That is the impression I got from your answer to my question.

Mr. MANSON. That is not true. The area that I mark "A" on here represents 160 acres. The area I mark "B" is supposed to

represent the adjoining 80 acres. This area "A" is owned by A and the 80 over here marked "B" is owned by B. Now, I will draw a line which I mark 1 at the top and 2 at the bottom. That is the line which bisects A's 160 acres. I will draw a line which I will mark 3-4 which cuts A's 160 acres into 40-acre tracts. Assume that A puts his well at a point opposite 3, which I will mark with a dot on this diagram. We will assume that that well is as close to the line as you can get it. That well will prove the east 80 of A's area and it will also prove B's area, the whole of it.

Senator CURTIS. You mean it is presumed to prove it?

Mr. MANSON. No; under the regulations it legally makes it a proven area.

Senator CURTIS. I know; whether it is in fact.

Mr. MANSON. Whether it is in fact is different. Now, A will get a discovery value on his east 80 which will be determined by estimating the quantity of oil under A's east 80. If B owns his 80 prior to the bringing in of A's discovery well, B will be entitled to a discovery value when B brings in a discovery on his property.

Senator REED of Pennsylvania. And the amount of that will be the same as A's?

Mr. MANSON. No; the amount of that will be determined by a separate valuation which will be based upon the production of the discovery well which B will bring in on his side of the line opposite the No. 3.

Senator CURTIS. The offset well?

Mr. MANSON. Yes; the offset well. If, however, B acquired this property after A brought in this well, then, under the regulations and under the existing law, he would not be entitled to any discovery depletion.

Under the proposed amendment by the House, B can save his rights to discovery depletion by contributing to the cost of bringing in A's well.

Senator REED of Pennsylvania. Whether he acquires it before or after?

Mr. MANSON. Yes.

Senator CURTIS. The answer to that is if he had not his lease there, if he did not own it, he would not contribute.

Senator JONES of New Mexico. As a practical proposition, do you not think whenever anybody is going to drill that somebody before drilling begins would have a lease or claim upon the adjoining land?

Senator CURTIS. Not always.

The CHAIRMAN. You can go further than 160 or 80; you can take a whole section of land. This map which I have here gives a whole section of land as to how field wells under the ruling could prove the whole section.

Mr. MANSON. There is a diagram in this report which shows how an area of 2,500 acres could be blanketed with discovery values and get a discovery valuation on every foot of it, contiguous areas. It is on page 38. The explanation begins on page 37. I have followed up one whole side of an area of some 2,500 acres.

Now, what I am leading up to in connection with this is this proposition: In the consideration of depletion of oil wells, particu-

larly, if the Congress should consider the allowance of a flat rate or a flat percentage of operating income——

Senator CURTIS. I will state here that I was going to offer an amendment providing for a percentage.

Mr. MANSON. What I want to bring out is that one argument that might be raised against a flat rate is that you would be allowing a depletion where it is not now allowed.

I desire to call your attention to the fact that if there is anybody that is not getting depletion now, it is because he has overlooked his opportunity, and I doubt it.

Senator ERNST. Do you mean by that that they get depletion where it is not deserved?

Mr. MANSON. I mean to say that under this law as it exists at the present time you can get discovery valuation on every foot of an oil pool which will give you a discovery depletion and that, therefore, if you fix your depletion upon a flat percentage of operating earnings you would not be giving anybody depletion that is not already getting it. On the other hand, if you desire to confine depletion to the depletion of capital actually invested or in existence on the 1st of March, 1913, you have to radically amend your discovery provision of the statute.

I merely call attention to the fact that the present discovery division of the statute is so broad that it will give discovery to everybody, that is, to practically everybody; and if you do not want to do that, then it is up to Congress to amend the discovery provision of the law.

The CHAIRMAN. The simplest way, I suppose, to obviate that would be to have a flat tax on the operating income.

Senator CURTIS. On the gross income.

Mr. MANSON. The committee that I represent has not taken any position with respect to the uneconomic soundness of discovery depletion, and I do not care to enter into any further discussion of it, other than I have done for the purposes of calling attention to the way it operates.

Senator REED of Pennsylvania. That is only going half way. Can you not give us any recommendations about the way this thing should be handled?

Mr. MANSON. Well, I can when I get through. I would rather cover some other phases of it because I have more reasons for the recommendations that I would make than those I have given.

The present law confines the discovery valuation to the value of the property at the date of discovery or within 30 days thereafter. In the case of mines and some deposits that 30-day limitation has been entirely ignored. I take it that the purpose of the 30-day limitation was this: Upon the discovery of a new deposit——

Senator SHORTRIDGE. Speaking of metals?

Mr. MANSON. Of metals; yes.

Senator SHORTRIDGE. Or a gold mine, for example.

Mr. MANSON. Yes; a gold or a silver mine or something of that sort. We will say that is discovered by a man who has not the capital with which to develop it.

Senator SHORTRIDGE. Does that mean the original discoverer?

Mr. MANSON. Yes; the original discoverer of some new deposit of some mineral. We will say it is discovered by some prospector

who has not the capital with which to develop it. The mere fact that he can demonstrate that there is something there, although there is no way to determine how much there is there, gives the property a value which it would not have if the prospect had not been discovered.

The only purpose that I can see in Congress limiting the value to be shown within 30 days—that is the provision of the statute—is that it was the intention of Congress that the miner should not be permitted to have an unlimited time within which to develop the full value of his mine, but that all that was intended to be discovered by discovery depletion was such value as could be developed within 30 days.

Senator SHORTRIDGE. And none could be in ninety-nine cases out of a hundred.

The CHAIRMAN. In 1918 it was 12 months; that is, I mean the report that we made.

Mr. MANSON. It was enacted in the law for 30 days.

Senator BAYARD. How is that, Senator?

The CHAIRMAN. In the report on the revenue bill of 1918 there appears this language:

> For the purpose of depletion allowance in the case of properties acquired prior to March 1, 1913, the provision of the present law, omitted in the House bill, has been restored by the committee, so that in the case of such properties, the basis for the depletion allowance shall be the March 1, 1913, valuation; but a proviso has been added that where mines or oil and gas wells have been discovered by the tax payer on or after aMrch 1, 1918, and not acquired as a result of the purchase of a proven tract or lease, and where the fair market value is material in its proportion to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of discovery or within twelve months thereafter.

That is what this committee thought at that time.

Mr. MANSON. Well, the 30-day provision was enacted in the law.

Senator JONES of New Mexico. When it was enacted in the law it was made 30 days.

The CHAIRMAN. Yes; I am only calling attention of the committee to the position that the committee took at that time; I mean the position that the Finance Committee took at that time.

Senator SHORTRIDGE. Does that apply to a gold mine the same as to an oil well?

The CHAIRMAN. Yes.

Mr. MANSON. It applies to all discovery depletion.

Senator KING. It is for discovery depletion.

Senator SHORTRIDGE. Certainly there is a great difference between a gold mine and an oil well.

Senator KING. You get depletion in addition to your discovery depletion.

Mr. MANSON. Now I want to call attention very briefly to one case that illustrates the department's practice with respect to mines.

In Alaska in drilling for oil in 1903 sulphur was discovered on a particular tract of land. There was not any particular attention paid to it at the time because the drillers were seeking oil. That property played out as an oil field and some St. Louis parties took hold of it for the purpose of developing it as a sulphur property. In 1909 they conducted drilling operations on the property for the purpose of determining the extent of the sulphur, and they found

a vein of sulphur 56 feet thick lying at various depths between 900 and 1,000 feet below the surface.

The CHAIRMAN. I think it was in 1908, was it not, because the question came up at the time we were making the tariff bill of 1909.

Mr. MANSON. You had another property in mind. You had the Union Sulphur Co. in mind.

The CHAIRMAN. Yes.

Mr. MANSON. The Union Sulphur Co. was organized in 1898 and finally got its property going in 1908. Now, regarding this property, the drilling operations for the purpose of ascertaining the extent of the sulphur were carried on in 1909, and, as I say, they discovered a 56-foot vein of sulphur lying between 900 and 1,000 feet below the surface. A discovery value was allowed upon that property as of 1919. You can see that the discovery value being allowed only upon mines discovered since March 1, 1913, would not apply to this property at all unless they could bring the discovery date subsequent to March 1, 1913.

The theory applied to this property and to many other properties was that notwithstanding the fact that the existence of the mineral was shown prior to this date, there was no discovery until it was ascertained by the construction of a $5,000,000 plant and the operation of that plant that the mine could be profitably operated. That is the construction that has been placed upon this statute.

Senator JONES of New Mexico. Make it a little clearer by telling the steps which were taken. The extent of the sulphur ore bed was ascertained in 1909, and then there was a reorganization or financing of the enterprise.

Mr. MANSON. Yes; there was a refinancing of the company. Now I want to call attention to this fact, that in this case there was nothing discovered after 1913. The process for the recovery of this sulphur was invented by a German and applied on the deposits of the Union Sulphur Co. in 1898. The Union Sulphur Co. was successfully extracting its sulphur by that process. The process is to force live steam, superheated steam, into the sulphur deposit and melt it and then recover the sulphur by compressed air pumping process. So that the process of recovery was known and the existence of the deposit was known prior to the 1st of March, 1913.

The CHAIRMAN. That is, the thickness of the deposit?

Mr. MANSON. The thickness of the deposit; yes.

Senator KING. They had a great many borings to discover its extent?

Mr. MANSON. Yes; there was a refinancing of the company. Now, The only thing that took place between 1909 and 1919 was that it took them some considerable time to raise the money with which to build the plant. Now, there is another case that I have in mind.

Senator KING. They allowed $38,000,000 discovery depletion on that property which cost them, as I recall, $250,000.

Senator JONES of New Mexico. That is what I wanted to find out, when it was that that $250,000 took place.

Mr. MANSON. That was in 1909. These people paid $250,000 for a tract of land which for any purpose other than mining operations was worthless, upon the strength of the fact of the existence of the sulphur discovery in that property by the oil-drilling operations.

Another case that I have in mind is the United Verde Mining Co.

Senator KING. Before you take that up let me ask you a question. In addition to the $38,000,000 discovery depletion which would absolve them from tax for a definite period, were they not allowed all expenses which they had been put to in drilling and depletion value from year to year as it was taken up?

Mr. MANSON. They were not allowed any depletion except depletion on the $38,000,000 value placed on the property. I think they capitalized their other expenses. They must have, because they had no income up to 1919.

Senator KING. That is, no income upon which they paid any taxes.

Mr. MANSON. The plant did not begin to operate until then, so they could not have had any income out of which to pay development expenses.

Senator COUZENS. Have you in mind, Mr. Manson, bringing to the committee's attention the case of the gold mines owned by the Vanderbilts?

Mr. MANSON. That is another case. What I am calling the committee's attention to now is that this 30-day provision has been given no effective recognition. In the case of the United Verde Extension Mining Co. the company had been operating for a great many years looking for an extension of the United Verde lode, and they had sunk a lot of money in the property. The property was recapitalized, I think, about 1912, and a large block of the stock—I think nearly half of it—was sold at a price which would fix the value of the property at $525,000. In 1915 they discovered the ore body. They ran into a very rich body of ore. Now, the discovery valuation made upon that property was made as of December 31, 1916. I do not know what date in 1915 they discovered the ore body, but at any rate instead of 30 days they were allowed something over a year within which to develop the full value of that property.

The Carson Hill gold mine is another similar case. This was an operating mine in 1913. During the high cost of operation period the mine was closed down as an operating mine. A man by the name of Loring discovered a gold deposit in 1916 that was near this Carson Hill Mine. Loring conceived the idea that his deposit ran into the Carson Hill property. He went to Mrs. Vanderbilt, who owned the property, and got an option under which he would have the right to purchase the property for $600,000, provided he found the gold, and he was given three years under that option within which to carry on explorations in the Carson Hill property. That option provided that any gold he recovered during the period he was carrying on these explorations would be put in escrow to be applied to the purchase price in case he exercised his option.

He discovered the rich deposit on the 25th of September, 1917. The taxpayer was not organized. The taxpayer did not come into existence until the 27th of November, 1917; that is, the corporation. When the taxpayer was organized on November 27, 1917, the option was assigned to the taxpayer. On the 30th of November, 1918, 14 months after the discovery of the deposit, the taxpayer notified Mrs. Vanderbilt that it would exercise the option and the transfer was made on December 28, 1918. Discovery value was allowed in that

case as of December 28, 1918. That is over a year after the discovery of the deposit.

I call attention to the fact that in that case at the time of the discovery of the deposit—now, this statute provides that the discovery shall be by the taxpayer—the taxpayer did not even exist.

Senator COUZENS. What discovery depletion was allowed on that?

Mr. MANSON. Something over $1,000,000.

The CHAIRMAN. Do you know whether they took that out?

Mr. MANSON. Yes; they took it all out and got it all back in 1919, 1920, and 1921.

The CHAIRMAN. It is not producing now?

Mr. MANSON. I do not think so.

Senator COUZENS. What was the net result of the enterprise?

Mr. MANSON. The net result of the enterprise was that they developed practically the entire deposit before they exercised the option.

Senator COUZENS. I mean the profit or loss in the enterprise.

Mr. MANSON. Oh, it was immensely profitable.

Senator REED of Pennsylvania. And there was $1,000,000 of their earnings that was tax free?

Mr. MANSON. Yes; something over $1,000,000.

Senator KING. By failing to apply the law to fix the value of discovery depletion within 30 days after the discovery.

Mr. MANSON. Without going into detail on the matter of valuation for depletion purposes, I want to say that I believe that it is absolutely imperative that some method of determining depletion be figured out as a substitute for the present method of basing it upon valuations. I do not think that any method could lead to more discrimination between taxpayers than the method which is now being pursued. We have not investigated a single oil valuation where two parties were interested in the same property where there was not a difference of at least 100 per cent in values placed upon the same property for depletion purposes for different interests.

Senator CURTIS. What do you mean by that?

Mr. MANSON. What I mean by that is this: Here is a lessor and a lessee, both of whom are being allowed depletion from the same property. The lessor is getting a one-eighth royalty. In that instance the lessor would get one-eighth of the oil. The depletion is figured upon a per barrel basis.

Senator COUZENS. The market price?

Mr. MANSON. Yes. Now, the lessor's oil is worth to the lessor more than the lessee's oil per barrel for the reason that the lessee has got to stand the expense of drilling the well and recovering the oil. So that the oil in the ground that goes to the lessor has a value to the lessor of more than the oil that goes to the lessee by the amount of the expense of recovery.

The CHAIRMAN. The lessee gets seven times as much.

Mr. MANSON. Yes; but the lessee has to pay out of his seven barrels the expense of his recovery, not only of his oil but the lessor's oil. What I wish to point out is that here is one property that is being depleted. Two different people have an interest in that property. The value of that property for these two different people should be the same, except that the lessor's value is a little

higher per barrel because the lessor is not required to stand the expense of recovery while the lessee is required to stand the expense of recovering not only his seven barrels but the lessor's eighth barrel.

I will just call attention to one case here right on that point.

Senator COUZENS. Is that the case of a partnership interest in an oil well?

Mr. MANSON. No; this is a lessor and a lessee case. I will call attention to a partnership case here in a minute.

On page 92 I discuss the difference in the valuation of a lease made for the lessor and one made for the lessee. The Gypsy Oil Co. was allowed a valuation on this lease of over $10,000,000. The fee belonged to a woman by the name of Atlanta G. Winchester. She got the value of the entire property figured upon the basis of the allowance to her, or $5,436,000. There is a 100 per cent difference between the value placed upon that property for lessee's depletion and the value placed upon it for lessor's depletion.

Senator REED of Pennsylvania. That is the value of the property and not the value of the respective interests?

Mr. MANSON. No; this is the value of the property.

Senator KING. But you would take the value of the property for the purpose of depletion and discovery for each.

Mr. MANSON. The value per barrel for Mrs. Winchester should have been higher than the value for the Gypsy Oil Co. because the Gypsy Oil Co. was required to stand the expense of pumping and drilling and whatever other expenses there were incident to bringing in and recovering that oil.

Senator REED of Pennsylvania. Its expenses, of course, were deductible from its gross income.

Mr. MANSON. Yes. Here you have a certain estimated quantity of oil in the ground. The value of that oil is determined by estimating the quantity and multiplying that estimated quantity by the price of oil and deducting from it the expense of recovering it. The value of a property that has got to be recovered is certainly reduced by the cost of recovering it, of reducing it to possession. The lessor has no cost of recovery because the lessee has to stand that. In this instance the value placed upon the property for the lessor's interest was only about half the value placed upon it for the lessee's interest, notwithstanding the fact that the lessor had actually a value which exceeded that of the lessee by the expense of recovery.

Senator COUZENS. When you speak of the lessor's being less than the lessee's value, you mean the value of the whole property?

Mr. MANSON. I mean the value of the whole property for the purpose of determining their interests.

Mr. REED of Pennsylvania. Obviously it ought to be at least as great in the case of the lessor as in the case of the lessee without stopping to enter into the question of expense.

Mr. MANSON. Yes.

The CHAIRMAN. This is the way the law of 1924 provided:

In the case of leases deduction allowed by this paragraph shall be equitably apportioned between the lessor and the lessee.

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Senator CURTIS. These cases were decided before this law went into effect.

Mr. MANSON. No.

The CHAIRMAN. The law of 1921 used nearly the same language.

Mr. MANSON. The lessee's depletion was contained in the 1921 act. The 1918 act contained no provision.

Senator REED of Pennsylvania. What explanation was given to you for that apparent discrimination?

Mr. MANSON. It was just made by two different engineers.

Senator COUZENS. Different periods.

Mr. MANSON. Different valuations made by different engineers. Here is another property. There are five partners who own a working interest in this property. The value placed upon the entire property now for purposes of determining the depletion allowable to each five partners in the case of the first partner is $152,000, in the case of the second partner $187,000, in the case of the third partner $187,000, in the case of the fourth partner $291,000 and in the case of the fifth partner $464,000.

Now, here you have one piece of property in which five different people have an undivided interest, and the value of the whole property for the purpose of ascertaining the undivided interest of each of them is given four different valuations. It happens that two of these partners got the same value.

The depletion unit per barrel in the case of the first partner was 41 cents. And, mind you, this would not vary with the partners because their interests were taken care of by giving them more or less barrels. This is a thing that ought to be the same in connection with all of them.

The CHAIRMAN. Did all five partners own the same proportion?

Mr. MANSON. No; but their proportions would be taken care of by giving them more or less barrels.

The CHAIRMAN. That is what I want to know in order to judge whether this was apportioned on the property.

Mr. MANSON. The basis of apportionment is on the basis of barrels.

The CHAIRMAN. I am speaking now not of the 41 cents you referred to but of the amounts you just named.

Mr. MANSON. That ought to be the same for all of them, too.

The CHAIRMAN. Well, was it?

Mr. MANSON. No.

The CHAIRMAN. I mean, was it in proportion to the amount of their interests in the property?

Mr. MANSON. Their interest in the property, in the first place, is reduced to barrels. I might get twice as many barrels as you do, but the total property would have the same value for the purpose of determining how much each one of us would get per barrel in depletion.

Senator SHORTRIDGE. Does the market value of the oil enter into the problem?

Mr. MANSON. No; these people all have an undivided interest in the same property, and the same value should have been given to the same piece of property, no matter what their undivided interests were.

Senator SHORTRIDGE. And no matter what the price was?

Mr. MANSON. No matter what the price was, because it is valued as of the same date.

Senator REED of Pennsylvania. There is no question of subsequent purchase by different partners?

Mr. MANSON. No; these are all discovery values, and, of course, the property is discovered by a discovery well. This is on page 95.

Senator REED of Pennsylvania. What was the allowance per barrel?

Mr. MANSON. For the first one 41.66 cents, for the second 51.15 cents, for the third 51.15 cents, for the fourth 79.65 cents and for the fifth $1.27.

Senator SHORTRIDGE. What explanation was given, if any?

Mr. MANSON. That the valuations were made by different engineers.

Mr. GREGG. Was that case taken up by the committee?

Mr. MANSON. Yes; it appears in our record on pages 2974 and 2975.

The CHAIRMAN. And in your report on page 95?

Mr. MANSON. Yes.

Senator REED of Pensylvania. Did not the 41-cent fellow put up a big kick?

Mr. MANSON. I do not suppose he knew anything about it. My recollection is that he found out about it and did put up a kick.

Senator SIMMONS. You say those reports were made by different engineers. Why could not one engineer make all of those reports if it pertained to one property?

Senator COUZENS. That is because they were checking up income tax returns.

Senator CURTIS. Could it be explained by the fact that at the date of one man's return there was a difference in value on the oil?

Mr. MANSON. No, because the value of the oil is taken at the date of discovery.

Senator KING. That is fixed by statute.

Senator CURTIS. How could they fix the value of the oil, then? How could the five men reach a different conclusion if it was fixed at the same date and at the same value?

Mr. MANSON. One man might estimate twice the quantity of oil. One man might use a 10 per cent discount factor and another man might use a 5 per cent discount factor.

Senator CURTIS. They could not use a different production cost. That is all run by pipe line reports. You have the run of every day. You know just exactly what the run was.

Senator COUZENS. But this valuation takes place before the pipe-line records are available. It is supposed to take place 30 days after valuation.

Senator CURTIS. No; you can get pipe line figures within 24 hours. No man pays unless he gets 10 days. In 10 days you can get the run of every oil well and for each and every day. I have bought a few oil wells and know what I am talking about.

Senator JONES of New Mexico. You do in your section of the country, but how are you going to figure it in San Juan County, New Mexico, where there is no transportation?

Senator CURTIS. Who buys your oil?

Senator JONES of New Mexico. It is shipped out under very serious difficulties and they are shipping out very small quantities because the charges are excessive.

Senator CURTIS. Down that way where there is a pipe-line proposition the pipe line runs right into the land.

Senator JONES of New Mexico. You are absolutely right when you are speaking of a pipe-line country.

Senator REED of Pennsylvania. It is not a question of the actual runs, Senator Curtis; it is a question of how much they shall allow this man on each barrel for a return on his capital investment. In order to get that you have to multiply the value of the oil, which was probably taken at the same price for all five partners, by the estimated quantity, and the trouble came from the fact that the engineers estimated different quantities for each of the five partners.

Mr. MANSON. If it had been purely a different estimate for the quantity, that would not make very much difference, because you get your value by multiplying your price by the number of barrels. It comes about in this way: You deduct the drilling expense from your value. If you have a big value and deduct the drilling expense, the drilling expense makes a smaller difference per barrel than it would if you had a small number of barrels.

Then, there is a difference in the use of the discount factor. One engineer might apply his discount factor for the middle of the year, while another engineer would apply it for the end of the year. Both practices have been followed.

Here is another case where two of these partners were interested in another property with two other outsiders. I have just given the depletion units here for the same property. J. J. Larkin got 28.5 cents and E. L. Connelly got 33.7 cents. The Margay Oil Co. got 60 cents and the Gypsy Oil Co. got 71.74 cents out of the same oil.

Senator COUZENS. Just tell the committee what the difference in the results would be if you used a 5 per cent discount factor or a 10 per cent discount factor.

Mr. MANSON. It would make a difference of about 100 per cent in your income.

Senator KING. Have you discussed the question that this depletion discovery is based somewhat upon the theory of encouraging the wild catter during the war and the fact that substantially all of this depletion discovery goes to operators and not to the wild catter? The wild catter does not get any discovery depletion, but it is the man who operates who gets discovery depletion.

Mr. MANSON. I have called attention to the relative figures.

The CHAIRMAN. The wild catter on public land gets a better rate on his royalty than if it were on proven land.

Senator KING. If I go out as a wild catter and run the risk and discover a well and sell it to you, I do not get any depletion discovery at all, and you go ahead and operate it and get the discovery depletion.

Mr. MANSON. No; your depletion would be based on cost there.

Senator KING. What do you estimate the cost?

Mr. MANSON. Whatever he pays for the property.

Senator KING. I do not get it.

Mr. MANSON. You get a limited tax but you do not get any discovery depletion.

Senator KING. So that the wild catter does not get the benefit of the discovery depletion which was the basis of the statute.

Senator REED of Pennsylvania. Does he not get that in case he sells to an operating company? Does he not get an allowance for the discovery value in calculating the profit that he makes on the sale?

Mr. MANSON. What is that, Senator?

Senator REED of Pennsylvania. If the wild catter sells to one of these operating oil companies his profit is the difference between his discovery value and the sale price, is it not?

Mr. MANSON. No; his profit is the difference between what he paid for the property and what he sells it for. He gets a limited tax. In other words, the tax, I think, is limited to 16 per cent.

Now, in the case of a corporation that has no application at all.

Senator REED of Pennsylvania. But a wildcatter himself who sells for 16 per cent profit does not have to pay full surtax, because that 16 per cent limit protects him.

Mr. MANSON. Yes; but he gets no other advantage for discoveries.

Our investigation of the valuations placed on metal mines, like copper and silver——

Senator JONES of New Mexico. Before you leave that oil business, I want to clear up a point in my own mind. You take the old established oil companies that are also engaged in developing new properties, in prospecting. Do they charge the expenses of that prospecting to the cost of operation?

Mr. MANSON. Yes.

Senator JONES of New Mexico. Or capitalize it?

Mr. MANSON. No; most of them charge it to cost of operation.

Senator JONES of New Mexico. What is the effect of that?

Mr. MANSON. The money they spend in prospecting is deducted from their tax as an operating expense, and, in addition to that, they get discovery value on the property.

Senator JONES of New Mexico. Then, there is this difference between the old established operating company and the new one which is engaged in the business for the first time, we will say: The wildcatter, the new wildcatter, he has no operating income against which he can charge his cost of prospecting.

Mr. MANSON. That is one of the arguments that was advanced for the discovery valuation. All I know about those arguments is from reading the record of the hearings before the committees. A man would go out and prospect for oil and spend several years looking for a property, and sink a lot of money in dry holes, during which time he would have no income from which he could deduct the losses which he sustained during that period. It was therefore argued that inasmuch as he could not deduct the accumulated losses he had sustained during the years when he had no income it was unjust to tax him upon the profits that accrued to him in the one year when he did have an income.

Of course, in the case of all large companies they deduct those losses which were intended to be recouped through discovery value from their operating expenses, and about 66 per cent of the discovery depletion is allowed to large operators.

Senator JONES of New Mexico. Who have charged cost of discovery to expense.

Mr. MANSON. Yes.

The CHAIRMAN. The same thing applies in the case of mines. A man goes out on the hills, but if a company is running he would not run long unless he spent money for the operating and developing of his property.

Senator JONES of New Mexico. I am not undertaking to condemn or justify the proposition, but I want to bring out all the facts here so we may have them before us in dealing with the subject. In the one case where it is an old established concern simply charging to expense the cost of replacement, we will say, he takes no risk, so far as his money is concerned—I mean for purposes of taxation—because the money which he uses has not been taxed; but the concern which has no operating income against which it can charge the cost of prospecting, etc., has an entirely different appeal, it seems to me, from the other concern.

The CHAIRMAN. It is the same in all business. An effort is required to begin business and operate before there is any profit at all.

Senator JONES of New Mexico. I know, but where there is one concern that has a large operating income against which it charges prospecting and replacement, that concern is in an entirely different position from the fellow who has no operating income against which he can charge these things.

Senator REED of Pennsylvania. Mr. Manson, I would like to turn back to these two cases that you gave us in detail. On referring to page 2974 of the record of the hearings of your committee I gather that the inequalities in this first partnership that you gave us having units ranging from 41 cents up to $1.27 were discovered in September, 1924, by Mr. Williams, an engineer of the Bureau of Internal Revenue, who was assigned the case of Seth Ely, and in reviewing that he found that various valuations had been allowed to these different partners, and he immediately requisitioned all of the other cases in order to attempt to secure uniform results, and as a result a valuation of the entire working interest was made, giving a uniform net working interest value of $181,000 for all of the partners with the same amount of reserves, and a 49.462 cents per barrel allowance was given to all the partners. In other words, the bureau found its mistake and rectified it.

Mr. MANSON. There are any number of cases——

Senator REED of Pennsylvania. Is that right?

Mr. MANSON. I do not doubt it.

Mr. GREGG. It is in your own record.

Mr. MANSON. I do not doubt it.

Senator REED of Pennsylvania. I think that is a very material factor for the committee to know in this case. I got the impression from what you said that this irregularity had been discovered by your committee and that the bureau had never done anything to fix it.

Mr. MANSON. I did not say anything of that kind.

Senator ERNST. That was the impression your testimony left, Mr. Manson.

Senator REED of Pennsylvania. Now, I want to call your attention to the second case you told us about, where J. J. Larkin got 28 cents allowance and his partner, Connely, got 33 cents, and the Margay Oil Co. got 60 cents, and the Gypsy Oil Co., a subsidiary of the Mellon concern, got 60 cents. I got the impression from the way you told it that these allowances had been made by the bureau, that your committee had discovered them, and that so far as anybody knew those inequalities were still prevailing.

Now I discover from page 2975 of your record that the discrepancies were discovered by the bureau itself and were corrected in July, 1924, by the bureau of its own initiative, and a uniform allowance of 60 cents given to each of those partners; also that that valuation has been used for Mr. Larkin and Mr. Connely who were the buts of the joke, and will, of course, be used in the cases of other taxpayers as they appear. Is that correct?

Mr. MANSON. I do not doubt it.

Senator SIMMONS. Senator Reed, what is the date on which that correction was made?

Senator REED of Pennsylvania. July 25 to 28, 1924.

Senator SIMMONS. I would like to ask Mr. Manson if his committee had made these discoveries before that correction was made and if the correction was made after you had made these discoveries and as a result of these discoveries?

Mr. GREGG. The memorandum of the agent of the counsel of the committee is dated May 21, 1925. These corrections were made July 25 to 28, 1924.

Senator SIMMONS. You made those corrections as the result of the pointing out by the Couzens committee of those errors you had committed in the department?

Mr. GREGG. No, sir. It is May 31, 1925, on the memorandum to Mr. Manson. It appears in the hearings.

Mr. MANSON. When was the statement made?

Mr. GREGG. It was taken up by the investigating committee on May 22, 1925. It was corrected by the bureau on July 25 to July 28, 1924.

Mr. MANSON. Now, I would like to ask this: How could you change a valuation for the Gypsy Oil Co. when all the Gulf cases were closed by 1312 agreement in 1923?

Mr. GREGG. Any case which had been finally closed under agreement between the commission and the taxpayer as provided by the statute, of course, remained closed, but the difference in valuation was discovered by the department before the committee ever got the case, and so far as it could be corrected, and in respect of cases pending not barred by the statute of limitations or covered by final agreement, a new revised value was applied to all taxpayers concerned.

Mr. MANSON. Yes; but so far as the Gypsy Oil Co. was concerned the correction was not made.

Mr. GREGG. If the statute prevented it, of course not.

Mr. MANSON. You just gave the impression here that you corrected it.

Mr. GREGG. In so far as it was possible under the statute of limitations, yes.

Mr. MANSON. It was not possible under the statute of limitations to make the correction which you gave.

Mr. GREGG. The valuation which had been made in 1920 in the particular case of the Gypsy Oil Co. could not be corrected, because it was barred by the statute.

Mr. MANSON. And the Gypsy Co. is still getting $1.27.

Mr. GREGG. That is a conclusion.

Senator REED of Pennsylvania. Of course, it is not in its current allowances, is it?

Mr. GREGG. After the year 1919, which was closed and barred by the statute, this case was never touched. When it comes up for later years it will stand on its own bottom.

Mr. MANSON. When that unit rate depletion is once fixed and the case is closed by a 1312 agreement it can not be touched. You gave the impression here that you had straightened this thing out, and as far as tax discrepancy is concerned in there it has not been touched.

Senator COUZENS. Because of a perhaps unfortunate inference left by Mr. Manson in this case I desire to make a statement. While this case was being discussed I told Senator Wadsworth that these criticisms were directed to the bureau because we had found no system, no method, and I know of none now whereby the same valuation is placed on the same property for the several divided interests.

I mentioned it before this discussion came up just now to Senator Wadsworth, that that was our main criticism, and I asked Senator Wadsworth to sustain the criticism that it was made because of the system, and it has not yet developed that any system prevails whereby these inequalities may be discovered.

I do not say that in these particular cases, or in perhaps one hundred other cases, discrepancies may not be discovered, but I still contend that nothing has been shown to this committee to indicate that a system exists whereby a taxpayer may be assured that the same value is placed on each undivided interest.

I ask Senator Wadsworth if I did not state that before this controversy came up? And I state it now because I do not want the committee to be put in the position that we claim that all of these were not straightened out at some time. I say there is no system in the bureau to insure that.

Senator WADSWORTH. That was the nature of the personal conversation that we had about five minutes ago.

The CHAIRMAN. Did you get the impression from what Mr. Manson said that those cases had never been settled?

Senator COUZENS. I did not have any impression ot it, because I did not follow up those cases. The question was whether these individual cases had been adjusted. I have taken a broader viewpoint in this investigation than the mere settlement of a few controverted cases. I have tried to approach the problem from a viewpoint of a system which insures equality upon all taxpayers, and I have been unable to find it.

The CHAIRMAN. I got the impression that all of these cases were never discovered until the committee had called attention to them.

Senator COUZENS. I never had any such viewpoint.

The CHAIRMAN. And I had the impression that there had been no settlement of them at all up to date.

Senator COUZENS. I had no such impression, because I knew that a lot of them had been settled. If Mr. Manson left that impression, I am sorry. My main criticism is that there is no system.

Senator SIMMONS. Mr. Chairman, that portion of the report which Senator Reed just now read indicates that some one of the various engineers that were working on this case discovered a situation as a result of the fact that he requisitioned the papers or reports of other engineers who had been dealing with the same question. That was some little time after these reports had been made and acted upon originally by the department, as I understand it.

Senator REED of Pennsylvania. Not acted upon, apparently, Senator, because one man was asked to work on the whole group.

Senator SIMMONS. I understand they had been acted upon because they corrected a former action. What you read was a correction of a former action, as I understand it, as the result of the discovery by one of the several engineers through requisitioning reports of the other engineers who had been acting upon this same case. They made this discovery and when they made it they made the correction.

Now, assuming that that is a fact, it seems to me that the criticism that Mr. Manson has been making was eminently a fair criticism. He had discovered a situation in the department by which these investigations were made by separate engineers of the same property reaching different results. If that situation existed in the department it is a situation which the department ought to have been able to correct. It shows, as Senator Couzens says, that there was some inefficiency there with reference to these matters. What they were criticizing, as I understand it, was that system by which this unequal result was accomplished.

Senator SHORTRIDGE. Assuming that there were inequalities, no one has yet explained how they arose. Perhaps Mr. Manson can explain that.

Senator SIMMONS. Yes; they have explained how they arose.

Senator SHORTRIDGE. I am told that those assumed and perhaps actual inequalities we have in mind arose from the claims that the different partners put in, one partner living in New York, one perhaps in Virginia, one in Georgia, and one in Maine. Is that not so, Mr. Manson?

Mr. MANSON. To some extent that is true.

Senator SHORTRIDGE. When a given partner puts in his papers or claim the subject matter is assigned to a given engineer who passes upon the matter. Another partner in another State puts in his claim and that claim is assigned to a different engineer who acts upon the matter. Thus inequality results.

Senator SIMMONS. I think you can fairly draw this inference, Senator——

Senator SHORTRIDGE. I agree with you, Senator, that there should be some bringing together of those matters so that one result would apply to all.

Senator SIMMONS. You can fairly draw this inference: If in this particular case a system has been adopted which brought about certain results as were brought about in this case, the assumption is that

there was like inefficiency in other of the regulations of the department leading to like disastrous results.

Senator REED of Pennsylvania. Senator Simmons, if that is a fair inference, then is it not equally a fair inference that the department of its own initiative will review those other cases as they reviewed this case and will find the irregularity and correct it?

Senator SIMMONS. If the department by accident discovers it, then they will do it.

Senator REED of Pennsylvania. But it was not an accident. The report shows that they asked one man to review the whole case.

Mr. MANSON. How does it happen that they did not assign a man to that until after the statute of limitations had run?

Senator SIMMONS. After that man had upon his own initiative requisitioned some papers and discovered this system.

Senator REED of Pennsylvania. Nothing that I have said here in criticism has been directed at Senator Couzens or at the committee. My complaint is that Mr. Manson, who has just shocked us all by bringing out these various contrasts and the treatment of the different partners, has only given us half the story, and I do not see why he gives us only half the story when he knows all the rest of it. I refer now to your report, Mr. Manson, at page 95, where you are talking about these Connely and Larkin cases. It gives the impression very clearly to me that in these two partnership cases the bureau has allowed these varying depletions; has made no correction of its action; and, in fact, I think it is fair to assume from page 95 that the bureau never knew of the inequalities until you called their attention to them. That is the impression I get from it and it is not fair.

Senator SIMMONS. I agree with you entirely about that. I am glad that Mr. Manson called our attention to this inefficiency in the first instance in the department. I think it is helpful. There may be other cases of that sort that have not been corrected. It is helpful criticism. I think Mr. Manson if he remembered that the department had subsequently corrected them he should in connection with his statement have called attention to that.

Senator REED of Pennsylvania. And I asked him if the man who had to put up the 28 cents did not put up a kick, and he said he guessed he did. I want the whole story.

Senator SIMMONS. That really justified the inference that there were other such irregularities.

Mr. GREGG. Because you raise that point, Senator Simmons, I should like to explain to you rather briefly what our system of checking valuations is at the present time. When the section was first built up and had this task of valuing all the oil and mineral properties of this whole country as of a date many years in the past, when that task was first thrust upon it it was too much for it to carry. For a while, until the section was organized, there was some inefficiency. But at the present time the work is carried on in this manner: The oil and gas section is divided geographically. The engineers in the subsection which deals with cases from Oklahoma and Texas are supposed to have experience with those oil fields. They pass on the case originally. In order to insure uniformity such a case is reviewed by the reviewing officer of that section of the country, the geographical section. After review by him it goes to the assistant chief of the sec-

tion for another review and then is reviewed by the section chief. The section chief's review naturally can be only the result of a cursory examination, but he has a chart or table based upon actual sales in the different fields to show the usual relations of sales in that field to the posted price of oil on that date, and he checks the valuation against those sales to see if it is in fair harmony with them. If it is not he has it taken out and examined. It seems to me, as far as the present time is concerned, we have done everything in the way of system to prevent these inequalities.

Senator SIMMONS. I hope it is not so, but when Mr. Manson made the statement that this inequality was brought about as the result of assigning the tax returns of the different partners to different engineers, it did seem to me then that the Department ought to have been put on notice that these various taxpayers who are partners in this concern and who are entitled to a separate interest in it represented one entity of taxation and the returns made by the partners in that concern representing that entity ought all have been assigned to the same engineer. It seems to me that was so simple and so clear that the Department was hardly pardonable in overlooking it.

Mr. GREGG. Attempts are made to do that in cases where we are put on notice.

Senator SIMMONS. Does not each return put you on notice? Because it shows that he is a partner in a particular mine and is claiming——

Mr. GREGG. No, sir; we get a return from New York and one from Oklahoma in which they claim depletion on one-fifth interest on a forty-acre tract in Kansas.

Senator SIMMONS. Is it not identified in the return?

Mr. GREGG. Yes, sir.

Senator SIMMONS. If it is identified and he owns only one-fifth of it you know that somebody else owns the other four-fifths.

Senator REED of Pennsylvania. These returns for the year 1918, which is the year involved here, came in on March 15, 1919. Who was commissioner then?

Mr. GREGG. Mr. Roper.

Senator REED of Pennsylvania. Mr. Roper was getting millions of returns in his office. It was in the peak of the war agitation. I do not think it is reasonable to blame the Commissioner's office for not trying to coordinate returns from different states.

Mr. MANSON. The valuations were made in 1922. If I had been permitted to state my conclusion on this subject this controversy would not have arisen.

Senator WADSWORTH. The controversy would not have arisen if you had led us to reaching a different conclusion.

Senator. COUZENS. In view of what Senator Simmons has brought out, I would like to ask Mr. Gregg if to-day I sold a fifth interest in one of these oil wells and the question of the profit was to be fixed so as to arrive at my tax assessment, if there is any record in the Bureau whereby you can go back and find out prior values put on the same stock as of different periods prior to the present date?

Mr. GREGG. I think so without a doubt.

Senator COUZENS. He only thinks so. We can not find any record in the department where we can go and find out the valuation

that was placed on an oil well in 1919, 1920, or any subsequent year to check up to see whether I get the same value put on my share of the well to-day.

The CHAIRMAN. I do not see how that could be otherwise than of record. It seems to me that before they could ever act upon a case in the beginning they would have to have the record and the record is certainly in the department.

Senator COUZENS. But I mean that it is dealt with by a new engineer to-day. He does not go back and find out if some other engineer had put a value on it at some other time, and there is no way for him to find out because there is no system whereby he can find out whether a prior value was put on that property or not.

Mr. GREGG. He can get it from the particular files of the particular case.

Senator COUZENS. If he knows who owns the property, but he does not. I contend that when the first valuation is made on a property it should be of record in the bureau, and every engineer required to go to that record and find out whether a prior valuation had ever been put on that property.

The CHAIRMAN. There was a prior valuation. Do you contend that that valuation is destroyed or that it is not in the department to-day?

Senator COUZENS. No; but there is no way of finding it.

Senator REED of Pennsylvania. Would not that involve keeping an assessment list of all property in the United States?

Senator COUZENS. I think it has to be done to insure equity. If there are 10 stockholders and they sell out at 10 different years and you go to fix a March 1, 1913 valuation, each engineer is going to fix a different value. It should be of record so that every engineer who comes to deal with the question can find out what the first engineer had placed as a value on that property.

The CHAIRMAN. You would have to keep a record here of every transaction in every State of the Union.

Senator COUZENS. I do not see how you are going to otherwise secure equity between taxpayers. In other words, if an engineer in 1919 puts a value on a piece of property of $1,000,000 because somebody sold a fifth interest, and then in 1925 somebody else sells a fifth interest and another engineer puts a value on the property of $2,000,000, the man that sells in 1925 gets less tax than the man who sold in 1919. That is, if the rates are the same. I mean that because one engineer in 1925 puts a value as of March 1, 1913, of twice the value that an engineer put on it in 1919, that creates gross discrimination between taxpayers.

Mr. MANSON. I would call attention to a case now where you have just as much discrepancy that has not been corrected.

Senator WADSWORTH. Is that in your report?

Mr. MANSON. Yes.

Senator WADSWORTH. What page?

Mr. MANSON. On page 85. It is the Black and Simons case. In the Black and Simons case two parties owned an undivided interest in the same property. Black was allowed depletion at the rate of 79.71 cents per barrel and Simons was allowed depletion at the rate of $1.76 per barrel. Now, Black's valuation was based upon an

actual sale of the property and Simon's valuation was based upon an appraisal of the property.

Black claimed the same value; that is, he claimed that he was entitled to the same value that Simons got, and he is now going to the Board of Tax Appeals to try to get it. I am assured by the department that if Simon's valuation is fixed by the Board of Tax Appeals, Black's valuation will be made to conform thereto, notwithstanding the fact that Black's valuation is based upon an actual sale of Black's interest.

As to the general subject——

Mr. GREGG. Are you through with Black and Simons? I would like to answer it.

Mr. MANSON. I would like to say something that I have been trying to say during all the time this discussion has been going on, and that is at the time I presented these cases to the committee it will be recalled that my criticism of the cases was based upon the fact that there was no system in vogue in the bureau whereby there would automatically be caught a variation in different valuations placed upon the same property; and my suggestion at that time was that what should be done was the maintenance of a tract index system for the oil fields, in order that when a valuation was claimed upon a tract of land in the oil field, the engineer could go to that card index system and find out whether there was another case in which a valuation had already been placed upon that same property.

There is no system and there is no method whereby a discrepancy in valuation can be discovered unless some taxpayer learns that he has not received as favorable treatment as someone else interested in the same property and makes a complaint and upon his complaint an investigation is instituted and the records in the different cases are requisitioned and compared.

Unless a complaint emanates from a taxpayer, there is no method set up, no system set up, in the bureau whereby the engineers have any means of protecting themselves against making this kind of an error.

Mr. GREGG. Taking up first the Black and Simons case which is criticized for the allowance of a different valuation. When this case was before the investigating committee we inquired into it and found out that the one who got the higher value had appealed to the board. The bureau was withholding action on the other case until the board decided the appeal, with the intention of settling both cases in accordance with the value determined by the board. In the committee reports the only objection to my answer to that case, is that "the Board of Tax Appeals can increase valuation allowed sometimes but can not reduce it," to quote from the report. In contradicting this part of the report I only have to refer to the case of the Hotel De France Co., where the board used this language:

> Where it appears to the board from the record that the deficiency determined by the commissioner is incorrect the board will, where possible, find the correct deficiency whether greater or less.

In addition, here are about three pages of citations with reference to increasing deficiencies determined by the commissioner.

Mr. MANSON. Is the commissioner urging that the defiencies be increased?

Mr. GREGG. I have not inquired into it.

The CHAIRMAN. You had better put that paper you have in the record.

(The paper referred to is as follows:)

Mr. GREGG: Per your request.

Commerce clearing house states in paragraph 5421, page 172:

"The Board of Tax Appeals has held that under the present law it has jurisdiction to determine the correct amount of the deficiency, whether greater or less than the amount of the deficiency of which the taxpayer was notified. This holding of the Board of Tax Appeals was an interpretation of the act of 1924 and was not in accordance with an express provision of the statute to that effect. The new bill, however, authorizes such jurisdiction by the board."

The Board of Tax Appeals stated in the appeal of Hotel De France Co., 1 B. T. A., 28:

"Where it appears to the board from the record that the deficiency determined by the commissioner is incorrect the board will, where possible, find the correct deficiency whether greater or less."

The board in this case had the tax recomputed on its own motion so that a proper deduction could be allowed for amortization on a leasehold, even though the commissioner had allowed a greater deduction upon the basis that the expenditure made for organization expenses was a part of the cost of the leasehold. The proposed deficiency was $4,271.21; the board found the deficiency to be $4,998.41, an increase of $727.20.

The question of depreciation was involved in the Rub-No-More case, 1 B. T. A. 228. The deficiency proposed by the bureau was $2,958.31: the board found the deficiency to be $12,702.61, an increase of $9,744.30.

In the appeal of the Record Abstract Co., 2 B. T. A. 628, after all of the evidence was in, the commissioner requested permission to amend orally his answer, alleging that expenditures made and claimed as rent deductions were in effect capital expenditures. The board accepted the commissioner's amendment and found that the correct deficiency was $8,113.21, an increase over the deficiency as determined by the unit of $3,169.01.

In the Fred Ascher case, 2 B. T. A. 1257, the board allowed the commissioner at the close of the hearing to amend his answer and allege fraud. The board found that a fraud penalty was proper. The bureau had proposed in the deficiency letter an additional tax of $8,030.70 for the year 1919 and $1,545.93 for 1920. The unit has now recomputed the tax under the board's ruling and has found a deficiency for 1919 of $9,713.80 tax and $4,856.90 penalty and for 1920 an additional tax of $1,545.93.

In the appeal of Peterson Pegau Baking Co., 2 B. T. A. 637, the board stated that it would, upon its own motion, assert a fraud penalty where the evidence clearly proved fraud. In such a case the deficiency would of course likely be increased.

In the decision covering the appeal of Gutterman-Straus Co., 1 B. T. A. 243, the board states that it has a right to find the true deficiency, whether greater or less than that proposed by the commissioner. (Signed, C. M. Charest.)

Senator SIMMONS. Mr. Gregg, when were those assessments made by which one partner was given a higher rate than the other partner? What is the date of the assessment?

Mr. GREGG. It does not state here when the valuations were made.

Senator SIMMONS. When did you discover the inequality in the valuations?

Mr. GREGG. I do not know as to when they discovered it. After the case was brought out we inquired as to its status and were advised by the engineering division that one of the cases was on appeal and that all questions of valuation in the other cases, as well as that one, would be settled in accordance with the decision on the appeal; and since the board can increase as well as decrease deficiency, we will get the answer which the board gives and apply it to both Black and Simons, which seems to me perfectly proper.

Senator SIMMONS. But you do not know what period of time elapsed after the appraisal was made until the error was discovered and brought to the attention of the Board of Tax Appeals?

Mr. GREGG. No, sir. The one that did not appeal to the board made his claim on a given valuation, and that valuation which he claimed has never been altered by the department. The other partner claimed a higher valuation even than the department was willing to allow, and that is on appeal to the board. We have never checked or altered the valuation of the person who did not appeal. That will be corrected once and finally in accordance with the decision of the board when it decides the case before it.

Mr. MANSON. Have you made any correction of the 100 per cent difference in the valuation allowed the Gypsy Oil Co. and the valuations allowed Atlanta Winchester on that lease?

Mr. GREGG. I do not know.

Senator JONES of New Mexico. Mr. Gregg, I would like to ask a question. After these reports were prepared they were all submitted to you, were they not?

Mr. GREGG. Yes, sir.

Senator JONES of New Mexico. And you were invited to make any criticism of them that you saw fit. Did you criticize these parts of the reports after you were thus given that opportunity?

Mr. GREGG. Connely and Larkin I had never gone into until just this minute when I went over to that table and went into the pages of the record to see if it supported the report.

Senator JONES of New Mexico. I signed the report with the understanding that after the reports were made up by Mr. Manson they were submitted to you and you were invited to make any criticisms of them that you saw fit and that you come before the committee and discuss them, but you did not make any of these criticisms which you are making now.

Mr. GREGG. Senator Jones, part of that report I was never called before the committee to discuss. This part I was. When I came before the committee to discuss the depletions part you will remember that I stated to Senator Couzens that "there is no use of my restating now or discussing now the specific cases which I discussed at the time of the hearings." That is in the record and I did not take up the specific cases for that reason. I stated at the hearing that I was not taking them up and why I was not.

Mr. MANSON. Do you remember my asking you whether there were any inaccuracies in statements of fact in that portion of this report dealing with depletion?

Mr. GREGG. I called your attention to the only one I knew of at the time.

Mr. MANSON. And I corrected it, did I not?

Mr. GREGG. You corrected it. The Connely and Larkin mistake I did not pick up until just this minute.

Mr. MANSON. If I had recalled at the time I wrote that portion of this report dealing with this particular subject the explanation that you made, I would have put it in there, because that section of this report was submitted to you and I asked you at the committee hearing whether there were any inaccuracies of fact, because if you knew of them I wanted to correct them.

Senator SHORTRIDGE. Had you not better withdraw that report and correct it before it goes out to the country?

Senator ERNST. I think it had better be corrected in a great many respects.

Senator SHORTRIDGE. I think if Senator Jones had observed that statement he would have corrected it.

Senator JONES of New Mexico. These reports were made up first in tentative form. They were submitted to the bureau for any criticisms which might be made by the bureau and there were no criticisms made, except in a very few instances, and they were corrected if they were found to be inaccurate.

Senator COUZENS. We have a stenographic report of what took place after these reports were submitted to Mr. Gregg.

Senator JONES of New Mexico. We all realized that with the vast amount of work that Senators have it was impossible for the members of the committee to go over this tentative report and check up every detail of it. The impression that I got from sitting at the hearing would cause me to believe as I read the report that that was in accordance with the general situation as developed in these very extensive hearings, and, inasmuch as the bureau did not point out any of these criticisms, I felt that I had a right to assume that they were accepted by the bureau, and, therefore, I signed the report.

Mr. GREGG. In case my attitude at this last hearing may have misled you, I want to restate now that only portions of the report were submitted to me.

Senator JONES of New Mexico. I assumed that they were all submitted to you because the committee directed that they all be submitted.

Mr. GREGG. They were all submitted to me, but I was asked to appear before the committee only with reference to a part of them.

Mr. MANSON. You were asked to appear before the committee with reference to this part of it.

Mr. GREGG. With reference to depletion I was.

Senator JONES of New Mexico. I asked you to appear before the committee with respect to everything where you wanted to appear. Did you complain of not having the right to appear?

Mr. GREGG. It would have certainly been presumptuous of me to complain of not being allowed to express my views.

Senator JONES of New Mexico. Did you make any written statement to the committee criticizing these matters which were referred to you and which were not taken up again in open committee session?

Mr. GREGG. No sir. The first three parts of the report were submitted to me and I was asked to appear before the committee upon them. I did on all three of them. I stated various objections to them. The last part I assumed would follow the same procedure but it did not.

Senator JONES of New Mexico. What was that?

Mr. GREGG. Dealing with special assessments and invested capital.

Mr. MANSON. The part dealing with invested capital was referred to you and you were heard upon it.

Mr. GREGG. I think that is probably correct. The last report I was not heard upon dealt with refunds and special assessment. I assumed I would be called but I was not. On the part I did appear on I stated general objections.

Senator JONES of New Mexico. I will ask to have put in the record right here what did occur in the committee regarding these matters. We have a stenographic report of it and I ask that it be inserted in the record at this point.

Mr. GREGG. Senator Jones, just to illustrate the fact that I could not possibly have gone into individual cases before the committee, this is a report of 240 printed pages. I had probably two weeks to go over it. There are 100 cases at least mentioned in this report, particularly in the amortization section, that were not taken up in the hearings of the special committee. If I had been called upon to express an opinion on those cases, it would have taken me the two weeks to have gotten the files on them. And to protect myself I stated at the hearings that I was not going to repeat discussion of the individual cases which had been taken up by the committee because each case that I had anything to say about I had discussed in the hearing at the time the case was up before the committee.

On the Connely and Larkin case, not five minutes ago, Senator Reed asked me if there was any explanation. I told him I was looking through the record to see. That was the first time I found that in the record of the committee.

Senator JONES of New Mexico. Without further discussion, Mr. Chairman, I simply ask that what occurred on it be inserted here.

The CHAIRMAN. Without objection that will be put in the record.

(The matter presented by Senator Jones is here printed in the record in full as follows:

From the stenographic record of the investigation of the Bureau of Internal Affairs, December 18, 1925.)

Mr. GREGG. What you want at the present time is our views dealing with depletion?

The CHAIRMAN. That is right.

Mr. GREGG. Of course, to go into the report in full and to give in detail our views and our answers, would take a great deal of time, and would result in too much repetition of what was said by the department in the hearings. I shall therefore just hit the high spots.

* * * * * * *

Mr. GREGG. As to those specific cases which are criticized in this report, I do not think that any good can come from rediscussing them. They have already been discussed pro and con in the committee hearings, and I have stated as clearly as I could what our position was. I do not think there is anything to be gained from repeating that.

Mr. MANSON. The only thing is, Mr. Gregg, that if I have made any misstatements of fact, it has not been done consciously, and I would like to have my attention called to it.

Senator WADSWORTH. If Mr. Gregg had been expected to familiarize himself with every single thing in this way, much of which relates to matters which were not handled in the hearing at all, he would have to be superhuman.

Senator JONES of New Mexico. During all these hearings before the committee Mr. Gregg was present after a certain time—I forget just when it was—and at all of the hearings the bureau was represented by counsel and assistants.

Mr. GREGG. Yes, sir. However, in the report there are a great many cases mentioned which the committee's staff worked on in the summer and which were never taken up by the committee.

Senator ERNST. At any time.

Senator JONES of New Mexico. You never complained of that to us.

Mr. GREGG. I am not complaining of it now. All I am saying is that I can not be expected to be familiar with all of those cases.

Senator ERNST. And I wish to state, furthermore, that no one could have stated more carefully than he did that what he had said before about these various cases he thought it entirely unnecessary to repeat. He did not waive his objections; he did not approve these reports; not by anything which he either said or did. The report is full of all manner of objections.

Senator SHORTRIDGE. It appears to me that he is acting as attorney for the committee and to my mind is acting more as a plaintiff's attorney trying to make out a case.

Senator JONES of New Mexico. I think you are in error there. This committee was not trying to make out a case.

Senator SHORTRIDGE. I do not say that the committee was, but I say that the attorney for it was.

Senator JONES of New Mexico. I think you are in error there. This committee was trying to ascertain the facts. We did not know what they were when we started in, and we never at any time assumed the attitude of trying to make out a case. What we did try to do was to ascertain the facts.

Senator SHORTRIDGE. I do not wish to be misunderstood. I say I do not think the committee did, but it appears to me that you individually as a member of the committee relied very much upon the attorney for the committee, and it appears to me that he was trying to make out a case.

Senator JONES of New Mexico. We relied upon our staff and the witnesses which came from the Internal Revenue Bureau altogether as to the facts, and I think it is an improper conclusion to draw that our staff was partisan in this matter and was bent on making out a case.

Senator SHORTRIDGE. I do not know who your staff was.

Senator JONES of New Mexico. Mr. Manson is one of the staff and Mr. Parker is an engineer, and I do not think it is fair to them, because I am confident in my own mind that it is not true that they were trying to make out a case. What we were trying to do was to find out the facts, and that is what we presented here.

Senator SHORTRIDGE. You did not present all the facts.

The CHAIRMAN. Mr. Manson has a few more words to say, and he would like to get through before we adjourn.

Senator SHORTRIDGE What does he want to talk about? Does he want to argue the case or present facts?

The CHAIRMAN. He has a perfect right to say whatever he wants to until some member of the committee objects.

Senator SHORTRIDGE. I do not care for any argument myself. I want facts.

Senator JONES of New Mexico. And I want to say here that one of my criticisms against Mr. Gregg and against the people who attended these committee hearings from the Internal Revenue Bureau is that they assume the attitude that they were being persecuted, and instead of trying to help our committee find out what was wrong in there, they tried to justify every act from A to Z that had been done in that bureau, and I want to express my criticism of the bureau in that respect, that instead of trying to help this committee to find some remedy for what was going on there consistently and persistently, they simply tried to cover up everything that they could or not bring it out, and in no instance undertook to suggest a remedy.

Senator ERNST. I think it is only fair to the committee—I was a member of that committee—to say that all of the committee do not agree with Senator Jones in that statement, but quite the contrary. I think if those who are representing the bureau had not taken the position which they did and had not brought out the facts which they did, they would not have been true to themselves or to their trust, and I saw no disposition exhibited by them at any time that honorable and fair men should not have exhibited in the defense of what I conceive to be in many cases the most unjust attack.

Senator WADSWORTH. May we proceed, Mr. Chairman?

The CHAIRMAN. Yes; proceed, Mr. Manson.

Mr. MANSON. I think it was apparent from the testimony adduced before the committee that the valuation method which I concede to be the only practical method available for arriving at values for depletion purposes is entirely unsuited to the purposes of taxation.

The CHAIRMAN. Do you not think that is necessarily so?

Mr. MANSON. I do not believe it possible to arrive at a valuation of a mine or an oil well for purposes of taxation by any method that will insure justice between taxpayers. I do not think it can be done. I think, for instance, the valuation made by the bureau of the copper properties varied as much as 300 per cent. I do not question the honesty nor the ability of the men who made those widely varying valuations. I do not believe it possible for any two engineers to value a mine or an oil well and arrive at a result that is even comparable without consulting and compromising on matters of judgment.

The elements of judgment involved in making valuations of this class are so great and there are so many of them that you could take small differences or judgment on each item and when multiplied together they will run into at least 300 or 400 per cent, run into differences which result in discriminations in the same industry which are so great that it makes it entirely unsuitable for purposes of taxation. I believe that it is absolutely necessary that some other means be found for determining depletion than basing it upon value.

I have not questioned the honesty nor the ability of the men who have made these valuations that I have called attention to here. As I have said before, I do not believe it possible for two men acting independently to get the same result. If two men acting independently got the same result through an analytical appraisal of any piece of property it would be an accident.

Senator REED of Pennsylvania. It would be almost suspicious.

Mr. MANSON. It would be almost suspicious, yes.

Senator REED of Pennsylvania. Now, what you are saying seems to me to go direct to the heart of the question that we are confronted with. As legislators we are interested in looking to the future and in establishing a rule that will work greater justice, and we are not here to try the rights or wrongs of what has passed. I want to ask you whether as a result of all your studies of this question you think a greater measure of justice in the long run could be established if we were to fix depletion allowance at an arbitrary percentage for all taxpayers on the selling value of their product?

Mr. MANSON. There is no doubt about it.

Senator REED of Pennsylvania. You think that would work greater justice?

Mr. MANSON. It would work greater justice.

The CHAIRMAN. The operating income of the mine.

Mr. MANSON. What I want to say is this: That it was not my purpose in presenting these discrepancies in valuations here to impeach the ability nor the honesty of the men who made them. I presented all of these discrepancies for the purpose of illustrating the futility of trying to arrive at a just measure of depletion through appraisal methods.

Senator REED of Pennsylvania. I hope the members will listen to this because I think this goes right to the heart of our problem.

Mr. MANSON. I have set up in the report a hypothetical valuation of a copper mine. I have taken the different elements that enter into valuation. I have assumed that two engineers were valuing the same property. In those two hypothetical valuations there are no differences in the different items that would exceed the differences that two honest, capable men could very naturally arrive at. In other words, there is nothing in those two valuations which I compare and which are so widely different by which you could impeach the honesty or the ability or the good judgment of the men who make them. Yet when you come to the sum total there is a difference of 458 per cent.

Any system which necessarily involves the delegation of this work to so many men, to so many engineers, who can not possibly confer as two or three engineers that might be employed by some owner or prospective purchaser would, necessarily must lead to the greatest inequities between taxpayers. I do not think anything illustrates that any greater than the wide difference in the valuations made in the first and second valuations of copper mines. Those valuations average 300 per cent difference. Taking the average all the way through there was an average difference of 300 per cent.

The CHAIRMAN. Did that come about by new discoveries?

Mr. MANSON. No; simply by varying judgment of two different sets of engineers. The first valuations were made by the most competent man that could have been obtained, a man by the name of Graton. There is not anybody that can question his competency. In other words, those properties were all new values. There were some errors found—that is, mathematical mistakes were found in them. There were some mistakes of appraisal. In other words, there were some instances where elements which should have been considered were overlooked; but on the whole the great difference between those appraisals arose out of a difference in predicting the future price of copper. One of them predicted a future average price of copper of 17 and a fraction cents, and the other 15 cents. If anybody on earth could review that work and say that either of them is wrong, I would like to know who that man is. I would like to know who can prove that a prediction extending over a period of 30 or 40 years is going to be wrong. It just can not be done.

If there is any one thing which I think has been shown conclusively, it is the fact that an analytical appraisal is wholly unsuited to the purposes of taxation and, furthermore, there is no other method of appraisal that is practical to apply.

Senator REED of Pennsylvania. Let us assume that that point is settled and we are driven then to some arbitrary percentage method and consider only the copper industry which you are talking about. If we adopt an arbitrary percentage of the sale price of the product to allow that depletion, will not that do great injustice, because you cannot apply the same percentage to the Lake Superior project or the vertical veins at Butte or the Porphyry mines in Utah, because there are totally different geological questions there, and a percentage that might be proper for the Utah copper company would be all wrong for the Calumet and the Hecla.

Mr. MANSON. I think if you will apply your percentage to annual earnings instead of the selling price of copper, you will overcome practically all of those inequalities.

Senator SIMMONS. Would you not overcome that, Senator Reed, by fixing an arbitrary rate beyond which the reduction could not take place.

Senator REED of Pennsylvania. That still leaves us with the matter of valuation. You still would have to have this appraisal which Mr. Manson has so clearly shown is unreliable, and I agree with him.

The CHAIRMAN. It seems to me the operating income of these mines is the best possible basis for arriving at the amount of facts and do the least injustice.

Senator REED of Pennsylvania. Suppose, then, we adopt that. That simply in putting in a different rate of income tax for mines and oil wells and lumber operations than for other products.

Mr. MANSON. That is just exactly what it means, but it is the only practical method, in my judgement, of handling the situation.

The CHAIRMAN. If it was only 20 per cent, that would be 20 for 12½, that would be less than 10 per cent.

Senator REED of Pennsylvania. That would be the same as saying that a railroad company shall pay 12½ or 13 per cent and a mine shall pay 10 per cent.

The CHAIRMAN. We can regulate that in the rates that we name.

Senator REED of Pennsylvania. And nobody shall be allowed any depletion. It seems to me that is probably going to work out a better measure of justice.

The CHAIRMAN. In this way, there would be no one to guess what it would be. If it is 100 years and the law is still in force, it would act exactly the same. I do recognize, however, that there is some little difficulty along that line, particularly with gold mines.

Senator SHORTRIDGE. You said you would base it upon operating expenses?

The CHAIRMAN. No; operating income.

Senator SHORTRIDGE. Over what period?

The CHAIRMAN. For the taxable year.

Senator REED of Pennsylvania. Senator, to take extreme cases, you have your copper mines at Butte that are practically inexhaustible and as against that you have a coal mine that would be exhausted in a year. That would work an injustice on the coal mine.

The CHAIRMAN. If they do not pay any more taxes there is not any hardship upon them. That is the difference in the product mined.

Senator REED of Pennsylvania. But they do pay more taxes because they are getting all their capital back in one year, as they are exhausting that mine in the one year, and instead of a depletion allowance of their whole original capital you are only giving them about two per cent.

The CHAIRMAN. The only way to meet that would be to impose a small rate upon the gross production. To meet the criticism offered by the Senator from Pennsylvania, Mr. Reed, it seems to me the only possible way to overcome those discrepancies referred to by him would be then to adopt a small tax upon the gross production of the mines, oil wells, and mines of all kinds.

Senator REED of Pennsylvania. Mr. Manson has just suggested that you could give the mine owner an option either to take a depletion allowance of 20 per cent of his net income or a depletion allowance based on the actual cost to him, without any valuation at all.

Senator SHORTRIDGE. Senator Reed, your thought is applied to mine operations?

Senator REED of Pennsylvania. By "mines" I include all natural resources.

The CHAIRMAN. I do not think that there is a member of the committee but what recognizes the fact that if we continue the law, and I do not care who we have as Commissioner of Internal Revenue or who your mining engineers are that pass upon it, we will not get very much closer than we have in the past. For instance, I have had five of the best engineers in the United States make an examination of a mine. Five of the best and most noted engineers, and I can show you those reports here upon what the value of the mine is on ore in sight, and there is 650 per cent difference between the highest and the lowest.

Mr. MANSON. And they took into consideration only the ore in sight.

The CHAIRMAN. Yes. Mr. Manson says he is through now with his testimony, and the committee will stand adjourned until 2:30 o'clock.

(Thereupon, at 12:30 o'clock p. m., the committee took a recess until 2:30 o'clock p. m.)

AFTER RECESS

The committee reconvened at 2:30 o'clock p. m., Wednesday, January 13, 1926, pursuant to the taking of recess.

The CHAIRMAN. The committee will come to order.

Senator WATSON. Mr. Chairman, before you start in on the Couzens report, and touching on it may I ask Mr. Manson a question or two?

The CHAIRMAN. Yes.

STATEMENT OF L. C. MANSON—Continued

Senator WATSON. How many cases in all did you take up and discuss with the select committee, Mr. Manson?

Mr. MANSON. Well, I don't know. I would have to check that up.

Senator WATSON. I think you said yesterday that there were five or six cases in amortization?

Mr. MANSON. Yes.

Senator WATSON. And yet your report embraces 160 more than that?

Mr. MANSON. Yes.

Senator WATSON. Now when was that report first submitted to the full committee of those 160 cases, to our committee, I mean the select committee?

Mr. MANSON. Well now, I would have to refresh my recollection from the minutes of those meetings. I do not remember when those meetings were held, Senator. I could not say off-hand.

Senator WATSON. How long after they were submitted to the Couzens committee, so-called, before they were reported to the Finance Committee?

Mr. MANSON. I will tell you how I did that, and then you can get the situation. The first section of the report that I got out was that relating to depletion and oil. A copy of that was submitted to Senator Couzens, and possibly a week later—that was in November, if I remember right, November 25—and possibly a week later, or something like that, a copy was sent to yourself, to Senator Ernst, to Senator Jones, to Senator King, and to the Treasury.

Senator ERNST. Let me state right there, the first copy of any part of it received by me was November 30. That was the partial report. That was the first time I ever received any part of it.

The CHAIRMAN. And that is what the minutes show?

Senator WATSON. Yes; the minutes show that. The minutes show the 30th, Senator.

Senator ERNST. Yes.

Senator WATSON. Now that was not the complete report?

Mr. MANSON. No. I got out next that part of it dealing with amortization. That went to each one of you gentlemen on the same day.

Senator WATSON. The 30th day of November?

Mr. MANSON. Well, I do not say what day that was. I do not know what date that was.

Senator ERNST. That was subsequent to that.

Mr. MANSON. What?

Senator ERNST. Long subsequent to that, no question about that.

The CHAIRMAN. What he meant was that it went to each one of you.

Senator ERNST. Yes, I know, but we want to get the dates, Mr. Chairman.

Mr. MANSON. I will have to refer to somebody else for the dates. I do not know.

Mr. CARSON. About December the 10th, that is when it was.

Senator WATSON. Yes, along about there. Mr. Carson says about the 10th of December.

Mr. CARSON. About that time.

Mr. MANSON. Now that portion of the report is the part that dealt with those 168 cases.

Senator WATSON. That is the part that we got about the 10th or 11th of December, somewhere along in there?

Mr. MANSON. Yes. In fact it was sent out as soon as it came off of the typewriters.

Senator WATSON. Now were you present at a meeting one day, I do not remember the date—Senator Ernst was not there. Senator Couzens, Senator Jones, Senator King and I were there.

Senator ERNST. That was during the holiday vacation when I was home.

Senator WATSON. Then the question came up about what disposition should be made of the report. This was before Congress convened in January, but between Christmas and New Year's. The question came up in that meeting about what should be done with the report, and at that time Senator Couzens suggested we sign the report. And at that time the question came up then as to whether or not it should be presented to the Finance Committee. You remember? You were in the meeting at that time?

Mr. MANSON. I think I was probably.

Senator WATSON. Yes. Now how long after that meeting before this report was made to the Finance Committee?

The CHAIRMAN. The report was made yesterday to the Finance Committee.

Senator WATSON. Yes, I know that.

Mr. CARSON. Senator Watson, I may answer. On December the 10th we had our first meeting, at which Senators Watson, Ernst, Jones, and Couzens were there.

Senator WATSON. Yes, we were all there.

Mr. CARSON. And at that meeting Senator Couzens made the motion that inasmuch as the Treasury had been present at all the meetings that a copy should be sent to the Treasury for their criticism and reply.

Senator WATSON. Yes, all right.

Mr. CARSON. And then on December the 18th Mr. Gregg replied on the depletion. And then on December the 30th Mr. Gregg replied on amortization, and some other sections of the report. Those are the three records of formal meetings.

Senator ERNST. You told me just a little while ago over the phone that upon last Monday the committee met, and three members, the Chairman, Senator King, and Senator Jones determined to report this matter to the Finance Committee.

Mr. CARSON. No, this is what I told you, Senator, over the phone, that on January the 6th a meeting was called. Senators Watson, Jones, King, and Couzens agreed to be present. Senator Ernst explained that he had to attend another meeting. Senator Watson before the meeting was obliged to explain over the telephone that he had another meeting. Senators Jones, King, and Couzens continued that meeting informally. It was agreed to get Senators Watson and Ernst to read the report, and if it was acceptable to them to await final signing of it and the reporting of it to the Senate. Then on Monday last Senator Couzens signed the report.

Mr. MANSON. You mean a week ago Monday.

Senator ERNST. This past Monday.

Mr. CARSON. Senator Couzens signed the report, and Senators Jones and King signed, and Senator Couzens said that he would delay filing the report to see if he could not get Senators Watson and Ernst——

Senator ERNST. Well, it was signed by those three last Monday.

Mr. CARSON. It was signed by those three last Monday.

Senator ERNST. That is my statement.

Mr. CARSON. There was no meeting.

Senator KING. I signed it in here in the session.

Senator WATSON. I wanted to find out what the committee had done.

The CHAIRMAN. Is that all, Senator?

Senator WATSON. Yes.

The CHAIRMAN. Did you want to say anything more?

Senator WATSON. No, that is all.

Senator ERNST. I want to make a statement, Mr. Chairman. On page 1565 of this record of the investigation of the bureau is the following. This is a statement made by the chairman, Mr. Couzens:

> For fear that any misunderstanding may arise in regard to what happened early in the morning with respect to contractual amortization the committee, that is, those of us who had heard the testimony, have been impressed with the absolute disposition on the part of the representatives of the bureau to cooperate in every way.

Now note:

> I can not think of even one request that we have been denied or in regard to which we have not received at least an earnest expression on the part of the representatives of the bureau that they would endeavor to get us the record.

Mr. MANSON. I have been in charge of the work of investigating the income tax since shortly before January, 1925, and I have never made a request for anything that I have not received as promptly as it was possible to get it.

Senator WATSON. And you stated that before the committee, Mr. Manson, several times.

Mr. MANSON. Yes, and I repeat it now.

Senator WATSON. Yes.

Mr. MANSON. Now, I did make the statement here the other day—yesterday, I believe—in connection with a couple of unpublished rulings, that after the 1st of June I had requested them and had not received them, but I do not make any point on that. It was made just as an illustration of the fact that unpublished rulings are not available. But so far as the records up to that time are concerned, I want to say that I received the fullest cooperation from Mr. Nash, who was designated by the Secretary as his representative in connection with this investigation; from Mr. Hartson while he was solicitor, and from Mr. Gregg since then.

Senator KING. Now, Mr. Manson, what is the fact, though, with respect to after June the 1st; no matter how important documents may have appeared in the investigation those were not obtainable, in view of the action of the Senate in limiting the time within which access to the records might be had. I do not say this by way of criticism.

Mr. MANSON. That is true. But I want to say this for the bureau, that they, however, put a very liberal construction on our rights under the resolution, and wherever we had called for papers in a case before that time, and we needed additional papers in those cases,

that they have not questioned our rights to them, and they furnished them promptly.

The CHAIRMAN. Did your committee ever make a request of the department that was not complied with?

Mr. MANSON. No; not to my knowledge.

Senator WATSON. Now, up to the 1st of June, when the right to go into the records generally was fixed—I think fixed by limitation of the resolution, as I remember?

Senator ERNST. That is right.

Senator WATSON. How many photostatic copies of records did you take of records of returns?

Mr. MANSON. Oh, I could not tell you.

Senator WATSON. Could you approximate them, Mr. Manson?

Senator ERNST. Oh, there were thousands of them taken.

Mr. MANSON. Thousands.

Senator WATSON. Yes?

Mr. MANSON. That is, I am thinking now of all the photostats that we have.

Senator WATSON. That is what I mean; yes; photostatic copies of returns?

Mr. MANSON. Yes. Oh, there are thousands of them.

Senator ERNST. Mr. Manson, you took copies in that way of these cases which are reported here, but which were not discussed fully before the committee?

Mr. MANSON. Oh, yes.

Senator ERNST. That was the manner in which you got hold of those papers, was it not?

Mr. MANSON. Yes: that is it. Now, for instance, in the amortization cases we called for all of the engineers' reports in those cases and received them, and some of them, where they had duplicate copies of the engineers' reports they gave us their duplicates. Where they did not have duplicates they made photostats of them.

Senator ERNST. Now, then, did you state the number of those cases which were considered by you and which were not brought before the committee in the regular way with the representatives of the bureau here to be heard, but which were considered by you from the copies which you had? Do you know how many of those are in this report?

Mr. MANSON. Well, I have referred to 168. Now I might explain something in connection with that. I do not think that answer would be a fair answer. During the sessions of the committee we could not devote all of our time to any one subject. There were a lot of subjects to consider. And it was not my purpose in presenting matters to the committee to keep presenting case after case involving the same principles.

It was, however, important to know whether the cases presented to the committee were typical cases, or whether they were isolated cases. The question arose frequently, was raised frequently by members of the committee, as to whether "Is this the practice, or is this an isolated case?"

Now on the matter of amortization, I went into that very thoroughly for the purpose of determining the extent of it, as to whether it merited legislative consideration. Whether it was some-

thing that was just one or two isolated cases, or whether it was something that was sufficiently extensive to merit legislative consideration. Now inasmuch as those additional cases involved the same questions exactly as the cases which had been presented and threshed out before the committee in detail it did not occur to me that it would be a profitable way for the committee or myself to spend time to go in detail through all of those cases. I have, therefore, referred to the cases in connection with each principle that is stated, referred to the cases that involve that same principle.

Senator ERNST. Well, now, Mr. Manson, I can not speak for other members of the committee, but I can speak for Senator Watson and myself. The first time either of us ever heard of these 168 cases was when you sent me a partial report. The first came November 30th. The last on a subsequent date. And those cases were never taken up by the committee and considered by the committee at any meeting at which I was present or of which I have been able to get any knowledge or information. Your report was drawn upon those cases. Now here is the printed report. It has been impossible for me to give it consideration, and if I had had nothing else to do but go over this report which you have made there would not have been time to make the kind of an examination which I would want to make of any report to which my name was signed. I do not know whether the other members found time to read it and examine it or not. I have not. Senator Watson has not. And for that reason I wanted this committee to know that many of these cases here have never been taken up by the committee at a time when representatives of the bureau were present to thresh out the questions involved, and the only time that any member representing the bureau has been present to be heard on these 168 cases was the one time—was it once or twice?—when we had these reports, and you asked certain questions concerning them of the present solicitor. I want that to be clearly understood by this committee.

The CHAIRMAN. Mr. Manson, did you want to say anything further on depletion?

Mr. MANSON. There is one other matter that I would like to call to the committee's attention. It does not relate to depletion.

I do believe that the compromise statute should receive some attention from the Finance Committee. It is a very old statute enacted long before—I think it is 3229; isn't that right, Mr. Gregg?

Mr. GREGG. Revised Statutes 3229; yes.

Mr. MANSON. Revised Statutes 3229. It is a very old statute, enacted long before the income tax law was passed, and was enacted for the purpose of taking care of ordinary internal-revenue cases.

The income tax law contains provisions making the tax a first lien, and making the Government a preferred creditor in bankruptcy cases. It has been the policy of the commissioner in making compromise settlements to settle not upon the theory that the Government was a preferred creditor, but to settle upon the principle that the settlement made should leave the taxpayer sufficient assets to take care of his other creditors, and to leave him sufficient working capital to continue his business. With respect to the policy as to that I have nothing to say. I think it is a matter of legislative consideration.

Senator WATSON. Let me ask you this right there. We discussed this in the full committee, I think at the last full meeting that I at-

tended. Do you think it ought to be the policy of the Commissioner of Internal Revenue to insist on the last dollar of taxes due by the taxpayer even though it drives him and his concern into bankruptcy?

Mr. MANSON. I think that there should be a consistent policy, and if you were to continue to make the Government a preferred creditor in bankruptcy proceedings and to continue to have the tax a first lien upon unsecured assets, that the compromise policy ought to be consistent with that. In other words, I do not think that you should have a situation where in case a taxpayer seeks a compromise he can protect himself and his general creditors, where the general creditors are not protected, do not receive similar protection where the taxpayer does not seek a compromise. If we are going to put general creditors ahead of the Government in cases of compromise, general creditors, it seems to me, ought to be ahead of the Government in all cases, and the rights of general creditors ought not to be dependent upon the initiative of the taxpayer in seeking the compromise.

Now as to the policy I have nothing to say. I think that that is a matter that Congress ought to determine. But I don't think that you ought to have the inconsistent policy of giving certain consideration to general creditors in compromise cases which are denied general creditors where the taxpayer seeks no compromise.

I understand that the policy that I have just been discussing was the policy of the commissioners of internal revenue extending over a long period of time, beginning in about 1918 and extending up until very recently, and that very recently that policy has been abandoned. I call it to the committee's attention because I believe it is a matter that ought to be straightened out by statute, and that Congress ought to fix the policy and have it a uniform policy applicable to everybody.

Senator JONES of New Mexico. Well, how could you remedy that question of compromise? What could be fixed as a basis to govern these cases?

Mr. MANSON. I think the commissioner ought to have authority at least to enter into compositions, in other words, where the other creditors of an insolvent debtor are willing to make a composition with the debtor so as to permit him to be absolvent from his debts without going through bankruptcy proceedings that the commissioner in his discretion should have authority to enter into a composition.

Senator JONES of New Mexico. But in a composition, as I understand it, all creditors deduct from their claims alike?

Mr. MANSON. Yes, they waive proportionately, and I would have the Government do the same thing.

The CHAIRMAN. That never has been the policy of the Government.

Mr. MANSON. I understand, Senator. What I am calling attention to is the conflict of policy. In other words, with respect to general creditors where there is a bankruptcy proceeding the Government says "We are going to stand first." But in compromise cases the policy is for the Government to stand last. Now I say that if you are going to abandon the policy of standing first you ought not to stand last. You ought to stand upon the same basis as any other general creditor. And with respect to that policy I think that is a proper matter for you gentlemen to settle. I do not think that my opinion on what the policy ought to be is worth anything more than anybody else's.

Senator JONES of New Mexico. Well, you say that this policy has been changed. What change do you refer to?

Mr. MANSON. Well, I base that statement that it has been changed upon representation made by Mr. Gregg to the investigating committee——

Senator WATSON. At our last meeting.

Mr. MANSON. At the last meeting, that the policy had been changed, and that it is now the policy for the Commissioner to insist upon a settlement which he believes represents all that can be recovered.

The CHAIRMAN. But does not the Government in that case reserve the right if there is more recovered to get it?

Mr. MANSON. No.

The CHAIRMAN. Do you say that the compromise then on the part of the Government puts them last?

Mr. MANSON. Puts them behind the general creditors, yes. Here is a concern which will be insolvent if the Government collects its tax. The policy is to accept that amount of money which will leave the taxpayer solvent, so that the general creditors of the taxpayer will not suffer and so that the taxpayer will also have enough working capital left free of the lien of the tax to continue in business.

The CHAIRMAN. Then at the time that they agree upon that policy or program the taxpayer pays the Government, but what does he do with his creditors? Do they still carry him on?

Mr. MANSON. Oh, yes, the Government is out of it then. It is nobody's business what happens to the creditors.

The CHAIRMAN. That is what I say. In other words, it is the judgment of the department that they can not pay 100 per cent of the tax imposed, and if they do they are insolvent. But if they pay 50 per cent of the tax, why then they can go on, and they accept the 50 per cent?

Mr. MANSON. Yes; and release the taxpayer.

The CHAIRMAN. And then the creditors go on and run the risk of him making good. If he does make good they get hold of it, and if he does not make good, why then they still lose perhaps what they would in the first place, and more too, perhaps?

Mr. MANSON. Yes.

Senator WATSON. In other words, it has been the policy of the Government in these compromises to so adjust the tax as to not drive the taxpayer into insolvency?

Mr. MANSON. So as not to force him into liquidation.

Senator WATSON. Yes.

Mr. MANSON. Yes; that is true.

The CHAIRMAN. I do not think the taxpayer would have very much credit if he was in that position to go on with business. It seems to me like he would have an uphill row to hold his head above water.

Senator JONES of New Mexico. I understand that they leave him enough working capital to go ahead with it.

Senator COUZENS. I think if Mr. Manson would explain the West Indies case that that would be typical of what he is trying to explain. I do not believe the members of the committee have got the exact status.

The CHAIRMAN. If there is a case I would like to have it recited. You can tell the substance of it.

Mr. MANSON. Yes. I would perhaps save time if I read this case. I am reading from page 185 of the committee's report. This is the Atlantic, Gulf & West Indies Steamship Co.

> The records of the Income Tax Unit show that this taxpayer resorted to every conceivable fraudulent expedient for the purpose of concealing the immense profits earned by it and its subsidiaries in 1917, 1918, 1919, and 1920, and that these frauds were expressly approved by the directors of the taxpayer. These frauds are set forth in the hearings, beginning at page 2036.
>
> An investigation by the Income Tax Unit was initiated upon the receipt of an anonymous communication which was sent by a former officer of the company. As the result of this investigation, in April, 1923, the taxpayer was notified of a proposed additional assessment of taxes for the years 1917 to 1920, inclusive, amounting to $9,083,033.75 and penalties amounting to $830,808.11. The legality of this proposed assessment of $9,913,841.86 was not questioned.
>
> This tax was compromised for the sum of $1,280,000 cash and the release of a judgment held by a subsidiary of the taxpayer against the United States for $1,351,381.81, or a total consideration of $2,631,381.81.
>
> On May 1, 1923, this taxpayer made an offer to compromise all tax and penalties for 1917 to 1920, inclusive, for $1,200,000, and this offer was increased on July 12, 1923, to $1,500,000 and modified to include 1921.

Now I recall the fact. A report was made in this case by an accountant for the unit that this taxpayer had unencumbered assets amounting to $9,709,407.77. This settlement was made upon the principle, without going through all the details here, that if this taxpayer was required to pay more than the $2,631,000 that it would force the taxpayer into insolvency. Now that settlement was made with the taxpayer and the stock of that taxpayer is now worth about $56 a share. At the time the settlement was made it was worth about $15.

Senator WATSON. How much tax did the Government get?

Mr. MANSON. $2,600,000 in round numbers.

The CHAIRMAN. Without the penalties?

Mr. MANSON. No. the whole thing was compromised for about $2,600,000.

The CHAIRMAN. And what was the whole amount before compromise?

Senator WATSON. $9,000,000 plus.

Mr. WATSON. Yes; $9,000,000 plus.

Senator KING. $9,083,000, and the penalties were $830,000.

Senator JONES of New Mexico. Nearly $10,000,000 with the penalty.

Mr. MANSON. Yes. Now that company was left with sufficient assets to continue in business, and it has continued in business, and its stock has constantly increased in value, and it is a going concern to-day. The representatives of the bureau stated that that settlement was made in accordance with the policy that I have attempted to describe here.

The CHAIRMAN. Suppose they had insisted upon the full assessment and the penalties, do you think the company would have gone on?

Mr. MANSON. Oh, no, I do not think so. I do not think the company could have paid the full assessment and continued in business. I believe that the company could have paid a great deal

more—in other words, I believe that the unencumbered assets of the company——

Senator JONES of New Mexico. The unencumbered assets.

Mr. MANSON. The unencumbered assets of the company would have afforded a great deal more if the company had liquidated, and the Government could have collected a great deal more money than it did collect, but I do not think that——

The CHAIRMAN. What year was this in that the compromise was made?

Senator KING. 1921. Compromise in 1923.

Mr. MANSON. Oh, this settlement was made in 1923 or early in 1924. I think the settlement was consummated about the 1st of January, 1924.

The CHAIRMAN. I meant what date was it that the agreed amount was reached?

Mr. MANSON. The agreed amount was reached about the time of the settlement.

Mr. GREGG. Just about the same time. The last part of 1923 or the first part of 1924.

Mr. MANSON. It was either December of 1923 or January of 1924.

The CHAIRMAN. They paid it as soon as the agreement was arrived at?

Mr. MANSON. Yes; I assume so. In fact, I think they are required to put up the cash when they make the offer, are they not, Mr. Gregg?

Mr. GREGG. Yes.

Mr. MANSON. Yes. I find that it was January 7, 1924.

Now it seems to me that that is a matter of policy that ought to be determined one way or the other.

The matter of compromise of tax penalties is another thing which I think should receive consideration. Under the statute at the present time the commissioner has no discretion in imposing the penalty. The penalty must be 50 per cent of the deficiency, without regard to how much of that deficiency is tainted with fraud. That has regard to the amount of the income which enters into the deficiency being tainted with fraud. If there is fraud in the deficiency, fraud in the unreported income, the fraud may be a small part of the income upon which a deficiency tax is assessed, the law is specific that the penalty shall be 50 per cent of the deficiency. Now the only way the commissioner can exercise any discretion is under the authority to compromise, and there is no minimum fixed there. The commissioner can compromise for as little as he sees fit.

Senator REED of Pennsylvania. I thought you said compromises were illegal?

Mr. MANSON. What is that?

Senator REED of Pennsylvania. I thought you said that these compromises were illegal.

Mr. MANSON. I do not think that the compromises of the penalties are illegal. I think that the compromises of the tax, under an opinion of the Attorney General, for less than the full amount that the commissioner can collect, is illegal. But I do not believe that there is any illegality in the compromise of penalties at any figure he sees fit to fix. And I believe that the commissioner should have

some discretion in imposing tax penalties. The discretion is now exercised in the compromise of penalties. If the compromise statute were not in the law, that is, were not a part of the general laws of the United States, it would appear to be the determination of Congress that there was to be a 50 per cent penalty in fraud cases.

Now it strikes me as being in a peculiar situation to have an absolute penalty fixed, and then under another statute the right to comprise that, when the place where discretion ought to be exercised is in the imposing of the penalty. If there is going to be discretion at all with respect to a penalty, that discretion should be exercised before the penalty is imposed. It is a good deal like sentencing a man and then trying him. And I think the commissioner ought to have discretion in imposing fraud penalties. I think there should be a minimum fixed, which minimum would be measured by the amount of income found to be tainted with fraud. And as to what that should be I have no opinion. I simply believe that there ought to be some minimum fixed.

Now we have found that the two largest elements entering into the large refunds are increases in allowances for invested capital, and in the allowances of special assessment. Those two grounds account for approximately 40 per cent of all the refunds made. I do not think that there will be any dispute between Mr. Gregg and myself on the proposition that the provisions of the 1917 act which define invested capital have not been observed by the department, and the provisions of the 1917 act which define the conditions under which special assessments have been granted have not been observed by the department. It has been explained to our committee that it was found that those provisions were unworkable, and that the matter was taken up with the Chairman of the Ways and Means Committee of the House and of the Finance Committee of the Senate, and that a sort of an agreement or understanding was made that the provisions of the 1918 act should be considered as retroactive.

Senator WADSWORTH. Retroactive?

Mr. MANSON. Retroactive. I merely call attention to the fact that the large bulk of the refunds that are now being made are made as the result of the application to 1917 of provisions of the 1918 act which on their face are not retroactive. I have set forth the particulars in the report.

The CHAIRMAN. Was there anything else?

Mr. MANSON. That is all.

Senator WADSWORTH. Well, have you any suggestion to make on that point?

Mr. MANSON. Well, it strikes me that if 1917 taxes are to be determined in accordance with the 1918 law, that there certainly should be some congressional authority for doing so. Because there are to-day right along being hundreds of millions of dollars of refunds made for the year 1917 that are made under statutes that do not exist, or rather, they are made contrary to the 1917 law.

Senator SHORTRIDGE. What is the position of the department in that respect?

Mr. MANSON. Well, as I stated a while ago their position is—of course I think that they are better able to state their position than I am, but the position they must have stated is that they have found

that the provisions of the 1917 act with reference to the limitations on invested capital were not workable, and that they have taken the matter up with the Finance Committee of the Senate and with the Ways and Means Committee of the House and worked out an arrangement whereby they applied the 1918 act to 1917.

Senator KING. Have you given an illustration of a tax arising under the 1917 act and the application of the 1918 act and the difference in the tax?

Mr. MANSON. Well, I have set forth in this report——

Senator KING. No, I mean have you to the committee here?

Mr. MANSON. No, but I can.

Senator KING. Just give one illustration, if you have it.

Mr. MANSON. For instance, the 1917 act contained this provision. It provided that where property was acquired by a corporation in exchange for its cooperate stock that such property should not be valued for invested capital purposes in excess of the par value of the stock exchanged therefor. It has been the consistent policy of the bureau to disregard that limitation, to make a valuation of the property, and to value the property for invested capital purposes without regard to the par value of the stock exchange therefor. Now the 1918 act permits the valuation of the property, and it is being taken into the invested capital at its value regardless of the value of the stock exchange therefor. It has been the consistent policy to ignore that limitation of the 1917 act and treat the 1918 act as operative for 1917 taxes.

Senator WADSWORTH. Why was not the 1917 act provision workable?

Mr. MANSON. Well, I do not know.

Mr. GREGG. I will take that up, Senator, the history of it, and the explanation of it.

Mr. MANSON. Now, I have cited any number of cases in here where it is done, and I do not think there is any question about it. The bureau has never claimed that it was not their general policy.

Now, in respect to special assessment, the 1917 act with respect to special assessment provided that special assessment might be granted where invested capital could not be determined. As I assume the members of the committee understand, special assessment simply means that under certain conditions, instead of determining the excess profits tax upon the basis of invested capital, that it shall be determined by comparing the rates paid by other concerns in the same industry. That limitation that the special assessment could only be granted when invested capital could not be determined has not been observed. The 1918 act provided that special assessment could be granted when there was such an abnormality in the invested capital or income as to impose a special hardship upon the taxpayer. And under those conditions special assessment could be granted. And the 1918 act has been uniformly treated as covering 1917 tax.

Senator WADSWORTH. Was the provision in the 1918 act confined strictly to returns to be made in that taxable year and the year afterwards?

Mr. MANSON. Oh, I do not think that there is any question but what the 1918 act applies to 1918 taxes, unless made specifically

retroactive. That is a question that I do not think there is any dispute about. Do you, Mr. Gregg?

Mr. GREGG. No; I think that is perfectly clear.

Mr. MANSON. Yes.

Senator KING. What is involved in these special assessments up to date?

Mr. MANSON. Well, that is a big question. I do not know. I know that in the refunds, in the large refunds exceeding a million dollars, that 43 per cent of those refunds were due to either special assessment or increase in invested capital, and the most of them arose under the 1917 law, and arose out of the application of the 1918 law to the 1917 tax. About $73,000,000 out of $171,000,000 arose from those two sources. Special assessment of $39,686,000 and increases allowed on invested capital of $34,155,000 in cases involving $250,000 and over. I said a million dollars; I meant $250,000.

Senator KING. In addition to that, what is the fact as to whether before settlement was had they made these credits base on the 1918 law? That is to say, were there credits allowed on the basis of special assessment for which no refunds have been asked?

Mr. MANSON. Oh, I assume so. The figures I have just quoted include abatements.

Senator WATSON. That is $171,000,000?

Mr. MANSON. Yes. Abatements over $250,000 made since June 7, 1921. If I am not mistaken.

Senator KING. Did you discover what claims were still pending based upon special assessment demands?

Mr. MANSON. No, I do not know. I do know that up to the 30th of April there were 13,000 cases pending. I am informed by Mr. Nash that that has been cut down in the last few months to about 6,000, is it?

Senator KING. Has been cut down 6,000 or to 6,000?

Mr. MANSON. To about 6,000. There are about 6,000 cases pending now.

Senator KING. I would like to ask Mr. Nash, if I may, whether many settlements were made upon the basis of special assessment being allowed before these refunds were taken up? Do I make myself clear?

Mr. NASH. Well, if you refer to what has been done in the past four years, we are making allowances on special assessments every day. But we do not allow special assessment to everybody that asks for it. Between 70 and 80 per cent of the claims made under special assessment are rejected.

Senator KING. It appears here that large sums have been allowed as refunds for special assessment, or based upon special assessment. What I am trying to get at is, were many claims settled upon which special assessments were allowed?

Mr. NASH. Why, I imagine that there have been several thousand cases settled in which special assessments were allowed.

Senator KING. They claiming many millions of dollars?

Mr. NASH. Yes, because we are still receiving those cases at the rate of about 200 or 250 a week. And they have come in a that rate for the last four or five years.

Senator REED of Pennsylvania. Is there not any end to that process?

Mr. NASH. Well, the statute of limitations.

Senator REED of Pennsylvania. When will that run?

Mr. NASH. Well, the statute of limitations has been extended by Congress from time to time, so that it is still possible, under some conditions, to file claims for 1917 and 1918 taxes.

Senator KING. Now?

Mr. NASH. Yes, sir.

Senator KING. So that everybody who settled in 1917 who has not already filed application to reopen and for a refund may, under these statutes which have extended the period, do so?

Mr. NASH. Under certain conditions, Senator. I think if he has paid his tax within the last four years he still has the right to reopen.

Senator KING. Yes. Are there many cases unadjudicated, or many that have not been settled?

Mr. NASH. Well, for 1917 we have just a trifle over 2,000 cases that are now in process of adjustment. That is, of cases in the income tax unit. That is not just for special assessment.

Senator KING. For 1917?

Mr. NASH. For 1917.

Senator KING. Yes?

Mr. NASH. And 95 per cent of those are claims.

Senator REED of Pennsylvania. How long do you estimate the 1917 cases will be in the bureau? When do you figure you will be cleared up for that year?

Mr. NASH. We will always have cases for 1917 while it is possible to reopen under the statutes. However, our present program calls for practically cleaning up 1917 by the end of this year.

Senator WATSON. Are there many of them being filed now for 1917?

Mr. NASH. Yes, sir; we have had 450 claims for 1917 filed in the last three months.

The CHAIRMAN. When does the statute of limitations run to?

Mr. NASH. I think that under some conditions, under section 3228, that it is possible to file claim on any 1917 tax in which the payment has been made within the last four years.

The CHAIRMAN. Will that continue? Suppose there is a tax paid next week, we will say, can they then open it up again within four years of that time?

Mr. NASH. As I understand the statute I think they can.

The CHAIRMAN. Well, we had better change it.

Senator KING. Let me see if I understand it. Do you mean if I paid my tax next week that I have got four years within which to reopen that?

Mr. NASH. Within which to file a claim for reopening; yes.

Senator KING. Regardless of the year for which I paid it? Supposing I paid it for 1918?

Mr. NASH. That is irrespective of the year that it was assessed?

Senator KING. That it was levied.

Mr. NASH. Yes.

Senator KING. If there has been a controversy between me and the Government say over a 1917 or 1918 tax, and I pay it next week, under protest or otherwise, I have got four years after next week within which to reopen that case?

Mr. NASH. That is my understanding.

Senator REED of Pennsylvania. In January, 1930, you can claim a refund on your 1917 tax.

Senator KING. We had better amend that.

Senator ERNST. That is wrong.

The CHAIRMAN. I thought that if a payment was made of this year's tax that could be reopened four years hence, but I had no idea that going back to 1917 it could be brought up to date and then four years more.

Senator KING. And then I suppose I would get interest at 6 per cent if you allowed my claim, from 1917?

Mr. GREGG. No, from the date of payment.

Senator REED of Pennsylvania. That makes a nice investment.

Senator SHORTRIDGE. Mr. Nash, does the Government recognize such a thing as an account stated? You know what I mean, do you not, as a lawyer? Does the Government recognize such a proposition as an account stated, where the Government and the taxpayer reach an agreement?

Mr. NASH. Well, under section 1312 of the 1921 act, and section, I think, 1006 of the 1024 act, the Treasury Department and the taxpayer can reach an agreement and sign a contract closing the case.

Senator SHORTRIDGE. And it becomes, as we say, speaking generally, an account stated?

Mr. NASH. Yes, sir.

Senator SHORTRIDGE. Well, does the Government still, or does the taxpayer have the right to open the account stated for the purpose of surcharging it?

Mr. NASH. The taxpayer has the right to reopen his case any time within the statute of limitations provided he has not signed such a contract.

Senator SHORTRIDGE. Of his own volition, without any showing of fraud or misrepresentation, or mistake? Just open it, notwithstanding it has become settled, or to repeat the word, an account stated between the two parties?

Mr. NASH. Yes, he can reopen his case at any time by submitting what he supposes is evidence to show that it has not been properly closed in the first instance.

Senator SHORTRIDGE. Well, that means opening it for surcharging it?

Mr. NASH. Yes, sir.

Senator WATSON. Even though he signed the contract?

Mr. NASH. No, not if he signed the contract.

Senator WATSON. If he signed it it is closed.

Senator SHORTRIDGE. When citizens having a running account come together and agree upon a balance they enter into an account stated. That becomes a new contract, and can not be opened unless there is a charge of fraud or mistake. I wanted to know whether the Government could come in at any time and reopen it?

Mr. NASH. The Government can reopen any case, or the taxpayer can reopen it, unless it has been closed either under section 1312, or section 1006 of the 1924 act. And we can open under those sections providing there is fraud.

Senator SHORTRIDGE. Yes. Now just a moment longer. Assuming the facts to be as stated by Mr. Manson, assuming his interpretations of the law to be correct, I understood him to say that you and the

department made the act of 1918 retroactive and applicable to taxes for the year 1917. As he stated it I can see no defense for that conduct. It seems to be palpable violation of the law. What is the explanation, if there be any?

Mr. GREGG. I was going to answer that and other criticisms as soon as Mr. Manson has completed his statement.

Senator SHORTRIDGE. All right.

The CHAIRMAN. Are you through now, Mr. Manson?

Mr. MANSON. I would like to say, at the conclusion of my testimony here that in connection with the Connelly and Larkin cases this morning I had no purpose to withhold the fact that those cases had been caught and to some extent corrected by the department. It was clearly an oversight on my part, and I think that any member of the investigating committee before whom I have been appearing for over a year, will bear out the statement that I have always tried to be absolutely accurate and to neither make an inaccurate statement nor to withhold any material statements.

Senator WADSWORTH. Then, Mr. Manson, I assume that this report of the select committee shall be considered to be amended in that respect?

Mr. MANSON. Oh; I want it to be. Oh, certainly.

Senator ERNST. Has it not already been filed in the Senate?

Mr. MANSON. Well, I assume that we would have a right on the committee print to amend that, but to attach an addenda to it, because I do not want any misconstruction of it.

Senator ERNST. Has it not already been filed in the Senate?

Mr. MANSON. I assume so. I do not want any statement of fact to be misconstrued.

The CHAIRMAN. It was filed in the Senate. The only way it could be done would be for the Senator from Michigan, or some other Senator, and he is the proper one, I think, to simply prepare the amendment to it and then offer it in the Senate as an amendment to the Senate document, whatever number it is.

Senator JONES of New Mexico. I will state to Senator Wadsworth that our committee met as a whole, all five of us present, and we considered how we should handle the making of our report, and upon my suggestion these tentative reports were to be submitted to the bureau officials for their examination and criticism in the same way that all reports on cases had been submitted during the proceedings of the committee. We took every precaution against anything slipping in or being in inadvertently which was not in exact accordance with the facts.

Senator WADSWORTH. I assume, of course, Senator, that you did. It is just a great misfortune that this thing got in without the subsequent information added to it.

Senator JONES of New Mexico. I think that it ought to be added to it, but in extenuation it is stated in there, if I recall, that the point which they were making was against the system which permitted such things to occur. Now the fact that they were afterwards caught and remedied does not at all ameliorate the situation which permits such things to occur, and the point that was being made in the report was that thing rather than what was actually done in disposition of the individual case. And to that extent the report is not

unfair if it is taken as a whole, and bearing in mind the point which was attempted to be substantiated by the discussion. But I agree that it might create some wrong impression to leave it in that way.

Senator WADSWORTH. To leave the impression that the tax had been settled on this basis.

Senator JONES of New Mexico. And I am quite willing that the addenda should be made or corrected.

Mr. MANSON. I would like to have the correction made, because I have tried to be very careful, in fact I was very careful, but there is an immense mass of testimony to be considered. There are many cases. This morning right here I got mixed up on two cases. I got the facts in two cases mixed in my mind.

Senator WADSWORTH. May I ask Senator Jones: Did Mr. Gregg make before your comittee that statement or its equivalent that he made this morning in describing the apparently very carefully checked-up system for securing accurate and dependable valuations on oil?

Senator JONES of New Mexico. He made the statement this morning, I think, that he had recently put into operation some such system. I never knew about that before. At the time of our investigation of this subject it did not appear that there was any such system.

Senator WADSWORTH. May I ask Mr. Gregg a question? Do you recall the statement? Mr. Gregg, have I identified the statement in your mind?

Mr. GREGG. Yes.

Senator WADSWORTH. You described the country being divided geographically.

Mr. GREGG. Yes.

Senator WADSWORTH. And engineers assigned to work in making valuations in the different sections, and those engineers were selected because they had personal experience in those sections.

Mr. GREGG. Yes.

Senator WADSWORTH. And so forth and so forth. How long has that system of making valuations been in effect?

Mr. GREGG. I do not know, Senator Wadsworth, except this, that when this situation was called to our attention by the investigating committee and we inquired of the oil and gas section the system was in effect which I described this morning at that time.

Senator WADSWORTH. How long ago did they make the inquiry?

Mr. GREGG. I should say that that was when this matter was brought up in committee, probably six or nine months ago.

Senator WADSWORTH. Of course, I know perfectly well that there are questions of opinion in this report, and I am not competent, and I do not feel willing now to argue the question with members of the committee. But in view of that statement that Mr. Gregg made this morning, and which he now says describes the situation which he says has at least existed for nine months, it seems to me that this sentence contained on the top of page 96 is a little harsh. I am wondering if the committee as a whole really wants to have it understood that they stand for it: "Oil valuations are so loosely made that they can not be said to be upon any consistent basis."

Senator JONES of New Mexico. Well, I am inclined to think that that is true yet. I do not know that I care to go into it now because it is rather technical.

Senator WADSWORTH. Well, I would not want a lengthy discussion. What I do say there, Senator Jones, is that that is an all-inclusive phrase. It gives the impression that all oil valuation is so loosely drawn.

Senator JONES of New Mexico. I think that is true, because here is the trouble. These valuations now are made upon the analytical basis, and the question about the assessment factor in figuring that thing up is just simply one which is not uniform, and it can be said, I think, that there is no system which brings about accuracy and uniformity in those valuations. I think that that can be said now.

The CHAIRMAN. And it is a human impossibility to do it. Mr. Gregg, will you proceed.

STATEMENT OF A. W. GREGG—Continued

Mr. GREGG. On the matters that have been taken up to-day by Mr. Manson it seems to me that there are three points to discuss. On depletion I do not think it is necessay to go into the specific cases that were mentioned as to what has been done in the past. They were answered in part at the time, and it does not seem necessary or advisable to discuss them further.

On the matter of future legislation I recognize, as Mr. Manson does, the difficulty involved in these analytical appraisals. I think everyone realizes and appreciates that. It comes down in the last analysis to a matter of judgment. The law requires that the judgment be exercised by some one. In the past I think it has been exercised certainly honestly and intelligently in the decisions of the cases. If something can be done, however, to relieve the department of the necessity of making those valuations it will certainly be a great step in advance.

Senator WATSON. Well, what could be done?

Mr. GREGG. That is what I was coming to. It has been suggested that depletion could be computed on a basis of a percentage of the net income from the operation of the property, computed without any allowance for depletion. That would relieve the department of a great many difficulties if it were possible.

The objections that occur to me to such a system are these: In the first place, in your solid minerals, you would very clearly have a different rate for each mineral. The soundness of the proposal would depend on the rate used. I do not think that we have now sufficient data to arrive at a proper rate. I tried at Senator Jones's request to get the data, and I got some with reference to oil and gas, which is not satisfactory, but I was not able in the time I had to get any with reference to solid minerals, particularly of the different types of solid minerals on which depletion is allowed.

Even if you have sufficient data to arrive at a proper rate, looking at the industry as a whole, it should be realized that that rate even in a single industry which is proper to apply to one deposit in one part of the country will be absolutely improper as applied to another deposit even of the same material in another part of the country where the expense of mining, the expense of production, the grade of the ore, may vary materially. The whole question comes down, if you have sufficient data to get a proper rate, as to

how far Congress would be willing to go in the interest of simplicity as against the exact logic of the question.

The CHAIRMAN. I do not see that there is any argument here as to the same mineral mined in different sections of the country. If we impose a tax upon the working income that can not be used as a basis of claiming that they are discriminated against in the different sections of the country. For instance, gold mining in California and gold mining in Utah and gold mining in any part of the country, without any tax at all perhaps would be different as to the cost of the actual work done or required to mine a dollar's worth of ore. That applies to the section of the country in which the man has made his investment, and he is trying there to develop a mine that will pay him in that section of the country. I think there is a great difference between metal mining and oil mining. Oil mining under this plan would be only for a life of four or five years, whereas metal mining, where you would ever get any tax from it that would amount to anything, runs for years and years and years. So there would be that difference, you know, applying to the two classes of production.

Senator REED of Pennsylvania. Well, now, Senator, just take that very illustration. You take copper mining, with which you are familiar. At the Utah Copper Mining Co. out near Salt Lake City the conditions are diametrically different from what they are in the Lake Superior mines, where the deposit is known with great exactness, and some of them are within a year of exhaustion.

The CHAIRMAN. Yes; that would apply even though there were no tax imposed at all. That is a condition that is existing here as to the life of the ore body.

Senator REED of Pennsylvania. I know; but you can not fairly use the same rate of depletion between those two companies.

The CHAIRMAN. There is no depletion on this program. The question of depletion is entirely wiped out.

Senator SHORTRIDGE. Well, what would be the basis then?

The CHAIRMAN. That is for us to determine.

Senator KING. A percentage of the profits.

The CHAIRMAN. A percentage of the net working income.

Senator KING. And profits.

The CHAIRMAN. Yes. And if they live fifty years they pay a tax for fifty years. If they live for one year, why they only pay the tax for one year, or two years, or whatever length of time they are operating.

Senator SHORTRIDGE. Well, is the tax on the net income?

The CHAIRMAN. Yes, the working income; that is, the actual money that they receive for the copper or the iron or the silver or the lead that is actually produced, the value of it.

Senator WADSWORTH. Gross or net?

The CHAIRMAN. The net.

Senator SHORTRIDGE. No matter what it cost to produce it?

The CHAIRMAN. The reason I should suggest the net is because there are some of the mines that smelt their own ore. Most of the mines, however, produce their metals and they ship the ore to the smelters for the refining. But it is what that miner gets for his profit, the amount of income that he receives, and the tax would be imposed upon that.

Senator SHORTRIDGE. Well, Mr. Chairman, gold is always of the same value, but the cost of producing an ounce of gold may vary extremely in different sections.

The CHAIRMAN. Well, it would not matter whether it was of the same value or not. You can produce gold perhaps cheaper in California than we can in Utah, but we can produce silver cheaper than you can.

Senator SHORTRIDGE. Yes.

The CHAIRMAN. So it is a matter of what you actually get in dollars and cents for your product, whether it is silver or whether it is gold or whether it is copper, lead, or whatever it may be.

Senator REED of Pennsylvania. In other words, you take account of depletion by giving them a lower income tax rate?

The CHAIRMAN. That is exactly it, and the only trouble in my mind about it is the oil industry itself, whether we would not have to make a different rate upon that than you would upon the metals produced because of the fact that the life, we know, is not the same length of time as the life of metal mining.

Now if you are through with that I would like to ask you in this connection whether you had given any study as to doing away with depletion entirely and imposing a small tax upon the gross production, and that could apply to oil or metals, and there would be no discrimination at all, and if they produce more in any one year they pay more. If they produce less they pay less.

Senator JONES of New Mexico. Mr. Chairman, I think that would work a great injustice, and I am very frank to say that any plan which has occurred to me will not result in exact justice. But it does seem to me that the plan which we have now is subject to innumerable objections, and that we must find some other plan, and I think we can find a plan which will be subject to fewer objections than the plan that is in the law now. We have got to figure this out on that theory, that we are not going to meet every objection.

The CHAIRMAN. Of course not.

Senator JONES of New Mexico. Now Mr. Gregg has said that he has been unable to arrive at a proper basis. What he means by a proper basis I do not quite understand. Or what particular facts he is seeking in order to get a proper basis I do not know. But clearly we are now supposed to give depletion based upon valuation of the property and various other things. Now it is true that any definite basis for deduction may be subject to criticism, but I think that we can reach a basis which is less subject to criticism than what we have in the law now.

Senator REED of Pennsylvania. Just because of that thought, and I confess that I have it as you have expressed it, I would like to ask Mr. Gregg the same question that I asked Mr. Manson this morning. Suppose, Mr. Gregg, that you were the whole Congress of the United States, how would you handle this troublesome question of depletion?

Mr. GREGG. I do not know, Senator Reed. We have been thinking of it to my knowledge since 1922, trying to work out some plan. We thought then of the possibility of allowing arbitrarily a given percentage of the net profits from the operation of the mine or well as depletion. At that time we were all impressed with the in-

equities of the situation, that that would result in grouping an entire industry at least under one head, giving each individual taxpayer within that group a rate of depletion based upon the average of the group, although it might bear no relation whatever to his own peculiar position. That objection still exists, of course. But if your rate gets low enough, in the interest of simplicity you can afford to be arbitrary and adopt a fixed rate admitting its arbitrariness and the inequalities which will result in individual cases from it.

Senator JONES of New Mexico. Now, we have this situation with respect to the oil industry. We have the large companies which try to keep up their replacement through charges to expense of operation, and deduct that from their net income. That is being done now, as I understand it, in a large percentage of the cases. But there is a large number of other concerns starting in to the business which have no net income from any source from which they can deduct the expense of exploration. Now it seems to me that there should be a uniform provision put in there so that those concerns shall be put upon the same basis, and the company which charges exploration to expense takes no hazard to that expense in carrying on its operation, and is not entitled to the same discovery value, we will call it, or depletion value on account of discovery that the other concern is.

The CHAIRMAN. Well, Senator Jones, that happens to-day. You or I go out onto the range now and wildcat and we spend our money; no one gets any credit for that, and why should they? That is an investment that the man makes. That is what you or I do; we are going to bet that we are going to get some oil here. But if we do find it then it is exactly the same as the metal mine, and we have got to keep up that exploration, or else we would not have any profit.

Senator JONES of New Mexico. I understand that, Senator. I am not warring against that thought at all, but if a large percentage of the concerns use capital in the development process then it seems to me that all concerns ought to charge these development operations to capital account and not reduce their net income from other sources by reason of that.

Senator REED of Pennsylvania. In other words, they ought to be compelled to form their accounts on the same basis.

Senator JONES of New Mexico. That is the idea.

Senator REED of Pennsylvania. One man should not put his drilling expense into capital account and the other charge it off to expense for the purpose of taxation.

Senator JONES of New Mexico. Yes.

Senator REED of Pennsylvania. Whatever he may do on his books.

Senator JONES of New Mexico. Yes, whatever he may do on his books for the company's statements, and so on, that is one thing, but I think for taxation purposes they ought to all be put on the same basis.

The CHAIRMAN. I think they are on the same basis to-day.

Senator JONES of New Mexico. No, Senator.

The CHAIRMAN. If a man goes out and wildcats and does not get anything, why he is not taxed. He is on that same basis. And everyone——

Senator KING. Excuse me, I do not think you got the point of Senator Jones. Let me give two illustrations. I go out and spend a million dollars in wildcatting and do not get a thing, and then finally get a well. I am not permitted to charge off or to get credit, rather, as a deduction when I get profits the million dollars that I lost in wildcatting. Suppose that you are the president of a going concern, and you have a large number of wells which yield a considerable profit each year. During the same time that I am wildcatting your company wildcats to the extent of a million dollars. You charge that million dollars against your income before you pay taxes. Your company gets an advantage over me of a million dollars.

Senator REED of Pennsylvania. That is true of every taxpayer that suffers a loss in one year, he can not get any benefit from another year.

Senator JONES of New Mexico. If I may just finish there. I think if we were to require that so far as this question of taxation is concerned that all the expense of prospecting and development of properties should be charged to capital account, and then give them a percentage of their net outgo as a reduction against their taxes, that we would be doing about as near justice as can be done.

Senator KING. I think it would be better to allow neither of them, and then make your tax light.

The CHAIRMAN. See where that would lead you to. You are taking out here more than you are expending, and you are adding here to the capital, and perhaps you are going to get something and perhaps you will not, and where will your capital be?

Senator JONES of New Mexico. It is only added to capital for taxation purposes, Senator.

Senator REED of Pennsylvania. Let me illustrate how that will work. I am told by Smith, the president of the Midcontinent Association, that they have spent $800,000,000 this year, 1925, for new drilling and for operating expenses in keeping up their production, their exploration. That the oil production to-day is the same as it was a year ago to-day from that origin. So that that can be considered as having been spent for the purpose of keeping the production level.

Senator JONES of New Mexico. A replacement fund.

Senator REED of Pennsylvania. Yes. And yet the total value of all the oil that has been taken out of that district this year he says is less than that $800,000,000.

The CHAIRMAN. I do not see how it could be otherwise.

Senator KING. I do not see how they spent $800,000,000 there.

Senator REED of Pennsylvania. I do not know about the figures, but he told me that at lunch time. So the industry can truthfully say that it has not made a cent on all its business of last year.

The CHAIRMAN. Well, you take the whole California field, if you want to, and I think there has been more money spent in southern California for the finding of new wells, almost, than there has been produced.

Senator SHORTRIDGE. I will not admit that statement. I do not want that to go undenied.

Senator JONES of New Mexico. I want to make another suggestion in connection with that point. Unquestionably there are concerns

which have spent the larger part of that $800,000,000 which have had income in excess of their share of the $800,000,000, and to that extent they have saved paying any taxes on that amount. And so where it has been deducted from net income as an expense or as a replacement cost, or whatever you may call it, then as to that concern, why the situation is entirely different from the concern which has used capital in this developement.

Senator REED of Pennsylvania. I think for the purpose of tax accounting every oil company that has an income has tried to charge off its drilling expenses as a deduction.

Senator JONES of New Mexico. Yes.

Senator REED of Pennsylvania. They have all done it.

Senator JONES of New Mexico. Now if they have done so it is just like a merchant who spends so much money in buying new goods.

The CHAIRMAN. Oh, no.

Senator JONES of New Mexico. And deducting that amount from his income in order to show his net income after the goods on the shelf have been replaced.

The CHAIRMAN. Oh, I can not see that, Senator.

Senator REED of Pennsylvania. Now, Mr. Gregg, I brought that up merely to illustrate what seems to me an insuperable difficulty in the calculation of percentages. Having said what I repeated, this Midcontinent representative then went on to say that the lowest possible percentage which could be arbitrarily set for their depletion would be 25 per cent of their gross income from oil and that anything less than that would not begin to compensate them for the disappearing capital in an oil well.

The CHAIRMAN. Well, that would be too much for a mine. You would not want that in copper.

Senator REED of Pennsylvania. Suppose you fixed that with their curves and charts in view, and they seem to make a good argument, if you apply the same rule to bituminous-coal mining not a single company in the United States will show any profit.

The CHAIRMAN. That is why I say there is the difference between the oil and the mineral.

Senator REED of Pennsylvania. So if we are going to ask an arbitrary percentage it has got to be a different percentage for different industries.

Senator JONES of New Mexico. And should it not be based on net income rather than gross income?

Senator REED of Pennsylvania. No.

The CHAIRMAN. Well, on the gross income, if you have that, there are hundreds of mines that work year in and year out and produce, but never make expenses. I know mines that are working to-day that are producing, but they have to make assessments every few months in order to go on.

Senator REED of Pennsylvania. Well, then, it is an academic question for them. They do not care what we do, because they have neither gross nor net.

The CHAIRMAN. Well, they have a gross.

Senator REED of Pennsylvania. They have neither gross nor net to pay any tax on.

The CHAIRMAN. They have a gross income.

Senator REED of Pennsylvania. Wo do not tax their gross income.

The CHAIRMAN. I thought you said the gross deduction.

Senator REED of Pennsylvania. No; we deduct depletion based on gross income.

The CHAIRMAN. Oh, we want depletion done away with entirely. If you are going to keep depletion in this thing leave it the way it is, with a few changes, but my idea is to do away with the question of depletion entirely and never have it thought of.

Senator JONES of New Mexico. I was going to suggest this, that in lieu of discovery depletion, and so on, that we allow a certain percentage of their net income to be deducted from it.

Mr. GREGG. That is what I understand Senator Reed was discussing.

Senator REED of Pennsylvania. That is tantamount to the same thing.

The CHAIRMAN. Well, the net income, there is something in that.

Senator REED of Pennsylvania. It comes down to the same thing in the end exactly, whether you allow an arbitrary percentage of deduction of net income, or whether you arbitrarily reduce the tax rate which is based on the net income. Giving 20 per cent credit on your net income for depletion is the same as reducing the tax 20 per cent. Now, suppose you try that, you get into hot water, because you take the iron-mining companies——

The CHAIRMAN. You mean the net?

Senator REED of Pennsylvania. Yes. Just take two instances. An iron ore mining company that mines its ore and sells it. You are going to tax them at the reduced rate of 10 per cent of their net income. Suppose they go on and smelt that ore and furnish the finished product, will you then tax them 10 per cent of their net?

The CHAIRMAN. That is a different proposition.

Senator REED of Pennsylvania. No; because you spoke a little while ago about taxing them on their output in its finished form, and the result is you will give the Steel Corporation 10 per cent rate and one of its competitors will pay 13½ per cent.

The CHAIRMAN. No; that was an entirely different proposition that I spoke of.

Senator SIMMONS. What is your proposition, Senator?

The CHAIRMAN. Well, there are two propositions. That you impose a tax of whatever percentage we agree on the operating income derived from a mine, whether it be a well or whether it be copper, or whatever it is. You take the operating income derived or the net income to that mine, and you then do not have to have anything to do with depletion. It is the production that counts. That is all there is to it. Now, the only trouble with that is between the oil and the metal mine. That is the trouble there, because the metal mining will run on for years, and the oil, of course, depletes itself within four or five years. Therefore it seems to me that we would have to divide that, and then take charge of the oil here on a percentage of depletion or a certain percentage to cover depletion. If it was an average of five years it would be 20 per cent. If it was an average of four years it would be 25 per cent, as you stated. And we would get away with the question of depletion entirely. I do not know how else we can do it.

Senator JONES of New Mexico. I think we can get away from this question of depletion by substituting for it——

Senator REED of Pennsylvania. I want to find out what the bureau has worked out in its studies. They have been trying to substitute something for it too. They are thinking along the lines that you and I are, Senator Jones, and I want to find out what position they have come to.

Mr. GREGG. That is what I said; we started on the percentage plan, and for the reasons which I stated to you, finally gave it up. Those reasons may not be insurmountable.

The CHAIRMAN. The percentage plan on what basis?

Mr. GREGG. Taxing the concerns on their net income without any deduction for depletion except an arbitrary percentage, 10, 20, 25 per cent of that net income computed without depletion.

The CHAIRMAN. Well, there would be trouble there, but why do you not go simply on net income? It would be a lower rate, but why go beyond that? Then if the Utah copper runs for 50 or 60 years why they have got to pay the tax for 50 or 60 years.

Senator JONES of New Mexico. By the way, I think I should call the attention of the committee to the fact that Senator Curtis made a request specially that he be heard when we discussed this letter.

The CHAIRMAN. Well, when are we going to decide the question? I know what his amendment is.

Mr. GREGG. Shall I go ahead with the other matters then?

The CHAIRMAN. Yes.

Mr. GREGG. The next matter that was taken up by Mr. Manson was the matter of compromises. He stated in answer to Senator Reed's question—and the report states emphatically—that in his opinion the policy of the department in compromising for less than the full amount which it could collect by enforcing its full legal right was illegal.

Since there have been a great many compromises for amounts, in a great many cases, substantially less than the amount which could be collected by the enforcement of our full legal rights, I want to refer as authority for our action to an opinion of the Attorney General contained in 17 Opinions Attorney General, p. 213, the last paragraph, where, by the way, this very question was submitted by the department to the Attorney General—this is in 1881—and the Attorney General held, I am quoting from his opinion:

> I have therefore to advise you that while in considering any compromise submitted to your department you are not at liberty to act from motives merely of compassion or charity, you are at liberty until Congress sees fit to limit your authority, to consider not only the pecuniary interests of the Treasury, but also general considerations of justice, equity, and of public policy.

The opinion discusses the whole thing at some length, and I will not take the trouble of reading it, but that is ample legal authority for the action of the department.

The CHAIRMAN. Put in whatever you want at this point.

Mr. GREGG. Well, I put in that citation and the reference to the opinion, which I think is sufficient.

Senator SIMMONS. There is no statute, is there, defining the rights of the department with reference to composing these differences with taxpayers?

Mr. GREGG. It merely gives us the right to compromise taxes, Senator, and this opinion which I have just quoted from says that we are at liberty to take into consideration in arriving at the amount of compromise considerations other than the one of what is the greatest amount we can collect by the enforcement of our full legal rights.

Senator SIMMONS. Well, of course, if you are required to collect the full amount you are entitled to collect under the law there would not be any compromise about it.

The CHAIRMAN. Well, could you state why this particular case referred to by Mr. Manson was agreed to and the amount was so much less than they could have paid?

Mr. GREGG. Yes; in that case I doubt if we could have collected the full amount, but the collection of the greatest amount which we could have collected by the enforcement of our whole legal rights would have forced this taxpayer, the Atlantic Gulf & West Indies Steamship Co., out of existence. We compromise it, therefore, for the greatest amount which in our opinion the company could pay without dissolution. That was the policy which was in effect and the policy which had been authorized in 1881 by an opinion of the Attorney General. The present policy of the department is to compromise only for the maximum amount which can be collected by the enforcement of the Government's legal rights.

The only solutions of the problem, it seems to me, are these. The continuation of the present policy of the department, which is a very harsh one in many instances. It is a drastic step to force a going business into dissolution or bankruptcy to collect taxes on income which it has received some four or five years previously. That policy, however, could be continued.

Congress on the other hand can write into the statute the old policy which was authorized by this Attorney General's opinion. Or Congress can authorize the Government to enter into a composition. I do not think that entirely meets the situation, because in many instances the creditors are unwilling to enter into a composition, but are willing to take securities of the new company in the hopes that they may pay out and they may collect the full amount of the claim. Or Congress can authorize the department, in case the taxpayer is a corporation, to take securities in the reorganization for the full amount of the claim, and more or less bet on the corporation pulling through and the collection of the full amount. Of course, if the Government were any other creditor it would do the last thing that I stated, take securities in the new company in the hopes that the company would pay out and collect the amount in full. Those are the only solutions of the problem. It seems to me that the last is probably the preferable one, although it will force the department into practically every reorganization, and will necessitate our taking securities, watching them, and disposing of them at the most favorable time.

The CHAIRMAN. The first loss will be the best one.

Senator SIMMONS. Do I understand you to say that under the present law it does not abate the amount of indebtedness which it could collect, but it does make arrangements by which the taxpayer is given time upon his furnishing security?

Mr. GREGG. At the present time we will not compromise for an amount less than the amount which in our opinion we could collect by throwing the taxpayer into bankruptcy or forcing him out of business. We do give extensions of time for payment in the hopes that the extension of time will enable the taxpayer to pull out to such an extent that he can meet the payment when it comes due. We have authority to give extensions only for a period of 18 months.

Senator JONES of New Mexico. I want to express my view that there is much of merit in Mr. Gregg's suggestion about the Government being permitted to take an interest in the business for a time. Now the case which has been mentioned more frequently perhaps than any other showing the hardship, is the case of the Flagler estate, where a large portion of his estate was tied-up in the stock of one railroad. The tax was high, and if you had been willing to step in there and forced collection of that money it would cause a great loss to the estate. Now in such case as that why not let it be figured out what the share of the tax amounts to with respect to the balance of the estate, and take stock in that railroad to that extent? Now I just mention that as an illustration of the general principle that Mr. Gregg has referred to.

The CHAIRMAN. You would want it only as a privilege?

Senator JONES of New Mexico. Yes, I would not want it as an enforcible thing at all.

The CHAIRMAN. There is only one railroad in a thousand that I would want the Government to go into.

Senator JONES of New Mexico. Now, there is another taxpayer who has an office building, or who has the major part of his assets in an office building. Now, why force the sale of that office building? Why not let the Government take a share in it, and let the Government dispose of it in time to an advantage?

The CHAIRMAN. That owner of an office building would not have any right to defraud the Government——

Senator JONES of New Mexico (interposing). I am not speaking of cases of fraud, Senator.

The CHAIRMAN. But there would be a back tax here, and if there is a back tax here, it might be fraud.

Mr. GREGG. No, sir.

Senator KING. Mr. Chairman, I think the only way—while we are expressing our opinions—is to collect the tax.

Senator WADSWORTH. I want to ask some questions of Mr. Gregg on that point, if I may.

Senator KING. I will not interfere.

Senator WADSWORTH. This last situation is the one that we must regard as the most favorable. If the Government took stock in a a corporation under the circumstances described by you it would necessarily have to be represented on the board of directors, would it not, to protect its own interests?

Mr. GREGG. I suppose, to protect its own interest, it would have to have some say in the affairs of the corporation.

Senator WADSWORTH. In the affairs and management of the corporation?

Mr. GREGG. Probably.

Senator WADSWORTH. How many thousand businesses would the United States Government be in in the next 10 years?

Mr. GREGG. These difficult cases—these tremendously difficult ones do not arise as frequently as you might think.

Senator WADSWORTH. I say thousands. That is comparative. How many businesses in the next two or three years, would arise, in the ordinary circumstances, where it would turn out—and I ask for information—that the Government would have to take a majority of the securities?

Mr. GREGG. That is possible, but not probable.

Senator WADSWORTH. There will be some?

Mr. GREGG. The question is what to do with these difficult cases where the Government can collect the full amount of the tax, but where such collection would force out of business a big industry. I can give you one illustration. It is pending now. It is the case of a big concern in New England. It owes us about a million and a half in taxes——

Senator WADSWORTH (interposing). For what year?

Mr. GREGG. For the years 1917, 1918, and 1919.

Senator WADSWORTH. The bad years.

Mr. GREGG. The bad years. And since then the company has lost all of its profits. It is in receivership now. The bankers, to protect their investments in the concern, are willing to advance about a million more to see if they can not put the company on its feet. Of course, they are not going to advance that when our Government has the priority lien on the assets of the company. Now, we can probably collect all of that tax by throwing the company out of business, and taking all of the assets, and throwing out of employment about 7,000 people in that little town in New England. That is an awfully hard thing, of course, to do.

Senator WADSWORTH. I know.

Mr. GREGG. Now, on the other hand, it does not seem right that we should take $300,000 or $400,000 for the amount of tax due, and then let the company run along with a probability that the other creditors will receive 100 cents on the dollar.

Senator REED of Pennsylvania. Mr. Gregg, it is a matter of indifference to the Government whether the interests in this concern are owned by the present owners, or by the owners who buy it at a foreclosure sale, is it not?

Mr. GREGG. Yes, sir.

Senator REED of Pennsylvania. So if you did not buy it at the foreclosure sale, some one else would have to buy it and operate it?

Mr. GREGG. In this particular case it would be broken up into lots. It could not be sold as an industry, I think. It is one of the biggest manufacturers of high grade writing paper in the United States.

Senator REED of Pennsylvania. Of course, if it was broken up and the industry destroyed, I can see the force of your argument.

Mr. GREGG. Yes, sir.

Senator REED of Pennsylvania. But I can not see that it mattered to the Government whether the fraudulent directors like in the Atlantic Gulf case, whether they continued to operate it, or somebody else operated it, who bought it at sheriff's sale.

Mr. GREGG. In that case I do not know what would have been the effect of a forced sale. But the properties would have been sold.

Senator WADSWORTH. Is there any way that the Government could secure to itself a payment of the balance of the taxes, except by this method?

Mr. GREGG. I should say in a majority of the cases, if we entered into a reorganization at all we should take only bonds. You see, we are a preferred creditor and could demand bonds, rather than stock. The holding of bonds would not draw us into the internal management of the corporation.

Senator REED of Pennsylvania. You would not get any better lien if you took bonds instead of extending your tax lien?

Mr. GREGG. No, sir.

Senator WADSWORTH. You might get interest in the meantime.

Mr. GREGG. An 18 months' extension is not sufficient. If we take rank with the parties who are going to advance the capital, there is more chance of their advancing the capital than if we precede them. It is a difficult problem.

Senator REED of Pennsylvania. We are getting pretty near to the end of the hearing, and I want to ask you about the other question of the extension of time in which these claims can be litigated. It seems to me preposterous that these liens can be extended——

Senator KING (interposing). Four thousand have been filed in the last month, I hear.

Senator REED of Pennsylvania. You mean 400?

Senator KING. Four thousand, I am advised. What is the number, Mr. Nash?

Mr. NASH. Four thousand, plus.

Senator REED of Pennsylvania. Now, Mr. Gregg, what have you to suggest in reference to that?

Mr. GREGG. We have made, I think, in this bill the biggest step forward that has ever been taken in that direction. This bill provides for complete administrative machinery for the determination of the amount of the deficiency. And it provides for exclusive machinery. In other words, the transaction starts, and the controversy starts when the commissioner sends a 60-day letter notifying the taxpayer of the deficiency. The proceeding can then go to the Board of Tax Appeals, and from there to the circuit court, and in particular cases, to the Supreme Court. After that controversy neither the commissioner nor the taxpayer can reopen that case; both of them have to present all of their contentions and claims in that proceeding, and whatever they fail to bring out in that proceeding, or whatever point they fail to raise there, are thereafter barred—both for the taxpayer and the Government. That, I think, cures the situation as to the future; at least, it is a big step forward.

Now, as to the past, I do not think we can take any action which will shut off any claims which are now legal.

Senator KING. Do you mean to say that the statute of limitations would be controlled by the legislative branch of the Government and

restrict a right which has been given, or rather a right to assert a claim?

Mr. GREGG. Well, this restricts it as to all future claims except claims now pending. It occurred to me the Congress would not desire to pass a statute now which would bar claims now pending on which the commissioner has not acted and which at the present time could be legally acted upon.

Senator WADSWORTH. Could we not shorten the four-year period?

Senator KING. That is what I mean.

Mr. GREGG. That four-year period corresponds with the Government's four-year period. The four years is the least we can do with it until we are more current than we are now.

The CHAIRMAN. You could not shorten cases now, and how are you going to shorten the retroactive provision? You can not do it.

Senator REED of Pennsylvania. In other words, the Government takes four years to get around to it.

Senator WADSWORTH. We had that explained to us in one of the earlier sessions.

Senator REED of Pennsylvania. Yes, sir.

Mr. GREGG. I will take up about two minutes to answer these last criticisms of Mr. Manson as to applying retroactively to 1917 the provisions of the 1918 act. It is a very important question, but I will deal with it briefly.

When the 1917 act was passed I was told—I was not with the department at that time—that it was rewritten in a great rush. I think Mr. McCoy and Mr. Beaman know much more than I do about that. It was recognized that it was very imperfect, and more or less strong-arm methods were going to have to be used to make it workable.

I would like to read in that connection a part of the report which Mr. Roper, then Commissioner of Internal Revenue, made at that time to the Secretary of the Treasury, dealing with these regulations criticized by Mr. Manson. It is on page 9 of the report of the Commissioner of Internal Revenue to the Secretary of the Treasury for that year, under the general heading "Income and Excess Profits." This report was rendered almost immediately after the passage of that act [reading]:

> Despite grave apprehension that the law could not be interpreted in a way that would admit of orderly and effective administration and the expressed views of many citizens that immediate amendments of the law should be sought from Congress before attempting to administer it, the department proceeded with the analysis of the law in the confidence that the congressional intent and purpose could be interpreted and put into effect without further legislative action and without serious detriment to industry and business.

I will put it all in the record, but will not burden the committee with it. It described the bringing together of a group of experts to work on this matter, to work out the regulations.

The CHAIRMAN. That may go in.

(The matter referred to is printed in full as follows:)

> The vital effect the enforcement of the law would have upon the economic activities of the country made it highly desirable to analyze and interpret the law in the light of all available information regarding business and industrial conditions and practices. The Secretary of the Treasury, therefore, selected to assist the Commissioner of Internal Revenue a group of prominent

business and professional men, whose training and experience seemed especially to qualify them for the task. This group was designated as "excess-profits tax advisors." It included men possessing extensive knowledge and experience in agriculture, manufacturing, trading, finance, accountancy, legislation, political economy, and sociology. These advisers were not only specialists in one or more of these fields but were keenly appreciative of the administrative responsibilities resting upon the bureau, and possessed much knowledge of business and industrial conditions in their respective sections of the country. They brought to the department a composite experience and breadth of view that proved of inestimable value in the study of the intricate law which the bureau was called upon to administer. The Solicitor of Internal Revenue and members of the bureau's legal staff and the administrative officers of the bureau were closely coordinated with the excess-profits tax advisors in their work.

The appointment of the excess-profits tax advisers had the immediate effect of inspiring confidence in the purpose of the department to administer the law with due regard for established business practices and with proper consideration of the effect the large rates of tax would have upon business activities. The tide of general criticism that had arisen against the law was stemmed, and the bureau began to receive innumerable expressions of confidence and offers of cooperation and assistance from accountants, lawyers, bankers, and business men throughout the country.

Mr. Gregg. Then here is the last paragraph [reading]:

Information, advice, and suggestions were sought from taxpayers through all known channels. Hearings were conducted for the oral discussion of the law and the concrete cases to which it would have to be applied. After months of thorough and painstaking deliberation regulations were issued interpreting the principal features of the excess-profits tax provisions and establishing the administrative procedure with reference to them. These regulations and the subsequent Treasury decisions and bureau rulings have been accepted generally as fair interpretations of the purpose and intent of the law.

That was the difficulty with which we were faced after the passage of this law.

Article 63 of the law, which deals with the paid-in surplus, and the article dealing with special assessment were both written in after that type of consideration. I do not know of my own knowledge—but I checked it with Doctor Adams, who was at that time with the Treasury, that at that time Mr. Cordell Hull, who was a prominent member of the Ways and Means Committee, sat in on the consideration of the regulations, and was a member of this committee which drafted them. After the regulations were drafted, Doctor Adams told me that he personally took them up to Mr. Claude Kitchin, who was at that time chairman of the Ways and Means Committee of the House, to get his approval of them. And he said that it was his recollection—and I did not have an opportunity to ask Senator Simmons to verify this—but he said it was his recollection that Senator Simmons was sent a copy of the regulations to get his reaction on them. That is the way these regulations were issued in order to make the law workable.

Senator Watson. Was the attention of the committee called to this in the consideration of the act of 1918?

Mr. Gregg. I was just coming to that, Senator. In the early part of 1918 these regulations were issued. They have stood from that date to this. No one has ever touched them. As to the fact that they were cited to Congress, I would like to call attention to the report of the Committee on Finance on the revenue of 1918, where

you put in the provision with reference to the paid-in surplus. The committee said:

This amendment seeks to enact into the law the substance of a regulation of the Treasury Department which would have the effect of preventing the filing of an excessive number of claims. It is highly important that this legislation be placed on the statute books, and a satisfactory basis continued.

In other words, these regulations which were of very doubtful legality were called to the attention of Congress at the time they were issued, and before they were issued, and then in the subsequent act of 1918 they were again called to the attention of the committee, and the committee in its report recites the fact that it is desirable that these regulations be enacted into law. It seems the Congress was sufficiently advised of our regulations, and in view of the fact that they have been in force since 1918 after a law which was hastily and, in spots, rather roughly drafted, and that they have stood and have never been touched and have been enacted into law. I think shows that they were well considered.

That is all I have Mr. Chairman.

The CHAIRMAN. Is that all?

Mr. GREGG. That is all I have.

The CHAIRMAN. It is now a quarter to five. Senator Couzens, do you want to say anything about it?

Senator COUZENS. I do not think I do. I do not know whether you have dealt with the question of publicity or not. I do not know whether Mr. Manson—I was out for a while while he was testifying—I do not know whether he has spoken about it or whether he has dealt sufficiently with that or not.

The CHAIRMAN. No; he has not said anything about it.

Senator COUZENS. I think, in view of the work that has been done that some of the committee or the staff of the committee should have something to say with respect to the publicity of these records dealing with the income tax department.

Senator JONES of New Mexico. I think, Mr. Chairman, that that is a subject which ought to be gone into with a good deal of care. I deem it one of the very important things which has to be considered.

The CHAIRMAN. Well, there are four members of the committee that are members of this committee.

Senator JONES of New Mexico. Well, I do not care to have the job of presenting the situation to this committee myself, and I do not know whether any other member of the committee is inviting the job when Senator Couzens and Mr. Manson have been gathering the various points which ought to be considered in connection with it.

The CHAIRMAN. Well, then, do you desire Mr. Manson to-morrow morning?

Senator JONES of New Mexico. Oh, I certainly do.

The CHAIRMAN. Mr. Manson, you can be here at 10 o'clock to-morrow?

Mr. MANSON. Yes, sir.

Senator WATSON. On what phase of it, Senator, may I ask you?

Senator JONES of New Mexico. I think that the time and the things which the Couzens committee has presented to this committee makes it apparent that something should be done which would not

involve all of these proceedings of the bureau there in absolute secrecy; that the time has come when we ought to devise some plan whereby Congress shall at least have an opportunity and the machinery for ascertaining how the laws are being administered and with the view of corrective legislation. And I merely throw out that, perhaps, as my own suggestion, but in order to fortify any suggestion, I think that Mr. Manson ought to be here and Senator Couzens.

Senator SHORTRIDGE. You mean to give suggestions as to proposed laws?

Senator JONES of New Mexico. Yes, sir.

Senator SHORTRIDGE. Or adding to the proposed laws?

Senator JONES of New Mexico. Yes, sir.

The CHAIRMAN. The committee will stand adjourned until 10 o'clock to-morrow morning.

(Whereupon, at 4.50 o'clock p. m., Wednesday, January 13, 1926, the committee adjourned until the following day, Thursday, January 14, 1926, at 10 o'clock, a. m.)

REVENUE ACT OF 1926

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

THURSDAY, JANUARY 14, 1926

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

The committe met, pursuant to adjournment, at 10 o'clock a. m., in Room 312, Senate Office Building, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Reed of Pennsylvania, Ernst, Shortridge, Simmons, Jones of New Mexico, King, Harrison, Bayard, and George.

Present also: Senator Couzens, chairman of the Select Committee Investigating Bureau of Internal Revenue, and Mr. L. C. Manson, a counsel to that special committee.

The CHAIRMAN. If the committee will come to order we will proceed. Mr. Manson, will you proceed with your statement on publicity?

Senator JONES of New Mexico. Mr. Chairman, I do not know that it is necessary to call Mr. Manson on that. I think I can make a statement that will probably suffice. The members of the committee here have heard the result of the examinations of the Couzens committee, and it seems to me that the situation requires an effort on our part to keep in touch with what is going on in the Internal Revenue Bureau. If the other members of the committee have not been impressed that way it is needless for me to try to make the impression now. But I think that the result of this work of the Couzens committee will be a saving of many millions of dollars of revenue.

I say that without impugning the motives or good faith of anybody connected with the Treasury Department. This committee has not attempted to follow up what appeared to be discriminations; I mean which resulted in discriminations, as between taxpayers, nor with a view of trying to suggest guilty action on the part of anybody. We have made no attempt in that direction. The purpose of the committee was to find out how these various provisions of the law were being administered; and my judgement is, and I think the other members of the committee must have been convinced of it by this time, from statements here of the Solicitor for the Bureau, that very important changes in procedure have been brought about as a result of the work of that committee.

I think it is important that the Congress and especially this committee—and when I say the Congress, of course, that means

the Congress through the Finance Committee of the Senate and the Ways and Means Committee of the House—should devote very earnest consideration to the remedy to bring us in touch with the operations of our own legislation. It is quite apparent that there is no method provided by law now whereby any of the actions of the Internal Revenue Bureau can come to the attention of the public except through those very few cases, relatively speaking, which reach a board of appeals or something of that sort. Wherever the taxes are settled to the satisfaction of the taxpayer there is no means now of knowing the basic of any such settlement.

I think that we should provide in some manner for a statement of facts in each case, especially if it involves any considerable amount, and that in some way that statement of facts should become known at least to some agency of this committee, so that we may know how our legislation is operating. The details of this I have not attempted to work out, but if the committee has reached the point where it feels that something of this nature should be done, then I am willing to go into the matter and give such help in adjusting it as I can.

One suggestion which I would offer is this: That the Finance Committee of the Senate and the Ways and Means Committee of the House should have some joint agency to keep in touch with the workings of that bureau. Here we are collecting each year in round numbers about four billion dollars from the people of this country. Everything done in connection with it is done in secret. All this army of employees down there is working in secret, and laying aside the question of good faith, honesty of purpose, or anything of that sort, it seems to me that some outside agency, and my judgment is that that agency ought to be connected with these committees, should keep in touch with what is going on down there, and that the Congress ought not to be dependent absolutely on what may be reported to it by the officials and people engaged in the administration side alone.

Senator McLEAN. Well, Senator, you know the House bill provides that both the House and Senate committees or any joint committees shall have access to all these returns at any time.

Senator JONES of New Mexico. Yes; but, Senator, take our Finance Committee; we can not do this work. I am not an expert engineer; I am not an expert auditor; nor have I the time to do that work myself. But this committee ought to have in its employ, in my judgment, some such staff, certainly not so large if a continuous staff, to do the very kind of work which the Couzens committee has been doing.

I know that it got abroad that there was some friction between Senator Couzens and Secretary Mellon and that that was the cause of all this thing. If I am convinced of anything in the world, it is the fact that this Couzens committee has not allowed prejudice to enter into its work at all; and not a single member of that committee, in my judgment, has indulged in any such purpose.

Senator SIMMONS. Personal controversies.

Senator JONES of New Mexico. Personal controversies. It has not entered into it. All that has been done has been an honest attempt to bring out the things which would indicate that some relief or difference in administration should be adopted.

Reference was made yesterday to the fact that we had brought out isolated cases. That is true and yet it is not true. There was no attempt to bring out isolated cases, but when our investigators started in they did not know where to look, only at the beginning being told by some one who had had some intimation that there was discrimination in a certain line and a suggestion that the case be looked into or a suggestion from a chance remark somewhere else that another case be looked into. That is why, perhaps, the idea might be suggested that we treated isolated cases.

There was no attempt on the part of the officials and employees of the Internal Revenue Bureau to sugest that any discrimination had taken place at all; and so it was in a sense by chance that we brought out what we did bring out. It is only by reason of bringing out particular cases and showing the discrimination that you can reach a conclusion as to whether or not things are moving along as they should move or whether there should be some change.

That changes have been brought about by reason of that work of the Couzens committee I think is admitted by all, and my judgment is that it is going to result in the saving of millions of dollars annually in revenue to the Treasury. If this committee had a continuing agency of that sort I think it would do away, in the first place, with this demand for general publicity about which we hear so much. In the second place, it would serve a very useful, and, in my opinion, an essential purpose in aiding this committee and in help to the Internal Revenue Bureau itself. I am assuming good faith on the part of everybody, but it is quite apparent here that we have not got that detailed supervision in the Treasury Department. Each official must rely upon the officials under him. Assuming that you have got any one in the Treasury Department having general supervision, that can not mean much when these cases are settled and adjusted by the thousands, solely by the authority, in fact, by the work, in fact, of the underpaid officials or employees of the bureau.

Senator McLEAN. Would you have this committee composed of Members of Congress or an outside body?

Senator JONES of New Mexico. I would have this committee composed of experts, and I want to say that that committee ought to be made up in such fashion that it can not be said that it is a whitewashing committee or anything of that sort; not to be subject to any such criticism as that.

As to recommendations for legislation, this committee and the Congress up to date, up to the work of this Couzens committee, has had to rely solely upon recommendations which came from the Secretary of the Treasury. I submit that that is not a proper basis for the framing of legislation. You see only one side of it. Now, understand me; I am not impugning bad faith to anybody, but the system is wrong, in my judgment. There are many details to this plan, but whatever we may do, in my judgment, about rules and regulations, unless this committee has an agency on the job all the time to see what is going on down there, we will not get very far. We become mere rubber stamps in a sense and we ought not to be such.

The CHAIRMAN. Senator, I think your statement is a little too broad. I know that great changes in the administrative features of this bill have been brought about by Chairman Green, of the Ways and Means Committee, and myself as chairman of the Finance Committee, referring letters received from taxpayers to the department and asking as to whether in their opinion the recommendations are proper and would assist the department if adopted into law. I simply say that I thought your statement was a little too broad where you said there was no one but the Secretary of the Treasury to submit to this committee suggestions for changes in the law. I do know that these things have been brought to the attention of the committee. Many of them have been turned down and a great many of them have been incorporated.

Senator JONES of New Mexico. But those suggestions on the outside came from people who have just seen the bad working of the law here or there. It is an isolated case. After all, what do we do now when such a criticism comes to us? We refer it to the Secretary of the Treasury.

Senator MCLEAN. It it your idea to have what we have in the States, a tax commissioner or a tax commission?

Senator JONES of New Mexico. Something of that sort, Senator, to represent the taxpayer as well as the collecting agency; in the main, of course, to furnish information to this committee.

Senator CURTIS. And to the Ways and Means Committee?

Senator JONES of New Mexico. And to the Ways and Means Committee of the House.

Senator REED of Pennsylvania. Would that tax commission be com posed of Senators and Congressmen?

Senator JONESof New Mexico. I should say no. That body should be under the jurisdiction of these committees, and they keep at work and make their reports to the Ways and Means Committee and to this committee, so that we may know what is going on.

The CHAIRMAN. Appointed by the President and confirmed by the Senate?

Senator JONES of New Mexico. No, sir; I would have them appointed by these committees.

The CHAIRMAN. I wanted to know your views on that.

Senator JONES of New Mexico. No; I want an independent body, something selected wholly separate from any influence; and, understand me, I do not mean to say that bad influence would be exerted, but we want it to be an independent concern so there will be no feeling of hesitancy in looking at things and reporting. We want an agency under our jurisdiction so we know what is going on.

Senator REED of Pennsylvania. Senator, have we any more right to require that than the Foreign Relations Committee would have to establish such a committee to inspect the State Department and the Military Affairs Committee to appoint a committee to inspect the War Department?

Senator JONES of New Mexico. I think not, and let me go a little futher now. I think that the Appropriations Committee ought to have a similar agency.

The CHAIRMAN. We have a budget, you know, to do that.

Senator JONES of New Mexico. I know and that helps some.

The CHAIRMAN. I think that it has helped a great deal.

Senator JONES of New Mexico. Every session of Congress we are changing.

Senator SIMMONS. The Budget has relation to the appropriation of money.

The CHAIRMAN. That is what the Senator is speaking about now.

Senator McLEAN. Senator Jones, in the States these commissions are, so far as I know, nominated by the governor and confirmed by the general assembly. Would you not be more apt to get something permanent in that way than to subject these appointments to the changing personnel of the two committees?

The CHAIRMAN. I do not think you will. I think you would get men then that would work directly in connection with the Treasury while if you had men representing the two committees, you would have men seeking information for the committees.

Senator JONES of New Mexico. Absolutely that is my thought, and I agree with the Senator that there is a good deal that can be accomplished by experts by suggestions of changes of policy in the departments. The only trouble with our suggestions now is that we send them in and we do not know anything about them; we have nothing but a letter from a constituent or somebody in the department. We submit them and the Secretary runs them down and says, "We have referred them to the chief and there is no use changing them." The thing for us to do if they have their experts is to simply authorize those experts to secure certain information as to practice.

Senator McLEAN. We do that now whenever we revise the law.

Senator CURTIS. We do it once about every two or three years.

Senator McLEAN. Do we not have such a claim?

Senator JONES of New Mexico. No.

Senator McLEAN. We ought to.

Senator JONES of New Mexico. I think so, Senator.

Senator CURTIS. We can fight that out when we come to consider the bill.

Senator JONES of New Mexico. Understand me, I am not putting this thing forward any further than to bring it to the attention of this committee. I am going to advocate something of that sort on the floor of the Senate if the committee does not take it up here.

Senator REED of Pennsylvania. Are you going to limit your advocacy to this one department and this one committee or to each of the executive departments, Senator?

Senator JONES of New Mexico. Inasmuch as this is a finance committee and we have to do only with one department, I think it ought to be confined to the work of this committee.

Senator REED of Pennsylvania. I should expect the Committee on Agriculture to want to have its commission.

Senator JONES of New Mexico. Senator, to be perfectly frank, I think that the Congress should have some agency which should go into every branch and department of this Government and know itself, through its own agency, what is going on. I do not believe in the Agricultural Department being turned loose to simply ask for appropriations of so much and we have to depend on the statement there as to how much they need, what work ought to be done, and everything of that sort. We have had under our rules committees

on expenditures in every one of the departments for a time. They did not do anything. The reason they did not do anything was that they had no means whereby they could do any work. We, as Members of the Senate, can not do it. We have not the time nor the technical skill to go into various branches of the Government service and ferret out a situation so as to make suggestions as to what changes should be made. I am not an expert accountant or an expert engineer, and I know nothing about this, but I say that this committee, so far as finance is concerned, ought to have under its control some agency which it can send in there and find out what is going on and what changes ought to be made.

Senator REED of Pennsylvania. I am not impressed with the suggestion that the Budget officer fulfills that function with appropriations. It seems to me he represents the Executive exclusively, and he does not represent the Congress, but he actually represents an abdication by Congress of a large part of its power.

The CHAIRMAN. But he gives the reasons for every appropriation asked for, and he holds hearings for every department and every bureau, and those reasons are transferred, if there is any increase or decrease in an appropriation, to the Appropriations Committee.

Senator JONES of New Mexico. But it must be admitted that that Budget officer gets his only information from the people who are spending the money, and we know the tendency on the part of every bureau and division of this Government is to expand.

The CHAIRMAN. Senator Jones, if you will go to the departments you will find out that every one of them will tell you immediately that General Lord has not given them what they asked for, that he is cutting the very life out of the service, and that he does not comply with the requests made, and I know personally that to be the case.

Senator COUZENS. May I make a statement, Mr. Chairman?

The CHAIRMAN. Yes.

Senator COUZENS. It seems perfectly apparent to me, and I think it is to the members of the committee, that there has been a wide difference of opinion on many subjects between Mr. Manson and Mr. Gregg, no doubt legitimate differences of opinion as to methods of administration, as to the statutes themselves, and as to the rules and regulations issued under the statutes; and I submit that if you are to go on the way you have been going that all your advice, all your suggestions are ex parte, that you have only one side of all of these issues. No one with an independent mind, outside of the Treasury, has any right to come here and make recommendations or suggestions as to the statutes, as to the rules and regulations published under the statutes, as to how these laws apply.

Mr. Gregg is here to-day and he may be gone to-morrow. When our committee first started we had Solicitor Hartson, a very competent and able solicitor, who appeared to represent the bureau. He resigned. Mr. Gregg comes in his place and he has his views and they are not in accordance with Mr. Hartson's all the way down the line. But, in any event, this committee gets nothing else but ex parte views as to the application of the law and a natural tendency to defend, and properly so, every act of the Bureau of Internal Revenue. No matter what anybody else's opinion may be, no matter what anybody else's observations may be, there they are, and prop-

erly so, to defend the conduct of the bureau. Now, this committee has no opportunity to get any other evidence or testimony on the opposite side. We have no opportunity to learn whether there is any different viewpoint.

The Senators themselves, as Senator Jones has properly pointed out, are not expert engineers; they are not expert accountants; so when you want expert opinion or expert evidence you get it all ex parte.

The other side—and there are two sides—is never brought before this committee.

It seems to me that the intent of the act in section 257 was something along the lines as Senator Jones has mentioned, because it specifically says that the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or special committee of the Senate or House, shall have the right to call on the Secretary of the Treasury for and it shall be his duty to furnish any data of any character contained in or shown by the returns of any of them that may be required by the committee, and that any such committee shall have the right, acting directly as a committee or by and through such examiners or agents. Now, I do not understand that either of these committees has appointed agents or examiners.

Senator ERNST. What are you reading from?

Senator COUZENS. Section 257. I do not understand that either of these committees has ever availed itself of the right under the law to appoint examiners or agents.

The CHAIRMAN. Do you not think that covers just exactly what Senator Jones desires if the committee acts?

Senator COUZENS. I think that is probably true, but they do not act. If they have no disposition to act they do not want to act; you can not make them act. I believe the Congress should make it mandatory for these committees to act.

Senator REED of Pennsylvania. Have we not the same question with every executive department, Senator?

Senator COUZENS. I do not think so, because in every other executive department the records are open. I am not here advocating publicity of returns; I am not here advocating the throwing open of all individual records of each taxpayer, but I submit that there is not another department in which you or any citizen can not go and ask to see the records.

The Senator from Pennsylvania, Mr. Reed, properly intimated that we should have a like committee for the State Department. I can go to the State Department and get the Secretary to show me things within the law. I can go to the Department of the Interior, the Department of Agriculture, and find out anything I want to. Any citizen can. But you can not do that with the Internal Revenue Bureau. There are billions and billions of dollars collected and millions and millions of accounts settled, all of which are secret, and when I say that I do not attach any bad motive to the secrecy part of it. I say it is humanly impossible for the Commissioner of Internal Revenue to know how six or seven million tax accounts are settled each year. I think section B of this act that I just read requiring the commissioner to prepare and make public the lists is perfectly ridiculous.

Senator HARRISON. Read that again where we have the right to appoint an examiner.

Senator COUZENS. It is in section 257 of the act now in force.

Senator CURTIS. It is in the new bill, is it not?

Senator HARRISON. It is not repealed?

Senator COUZENS. No. He says both of these committees shall have the right to call on the Secretary of the Treasury for and it shall be his duty to furnish any data of any character contained in or shown by the returns, or any of them, that may be required by the committee, and any such committee shall have the right, acting directly as a committee or by and through such examiners or agents as it may designate or appoint, to inspect all or any of the returns at such times and in such manner as it may determine.

Senator HARRISON. All that would be necessary, then, would be for us to get an appropriation and have this committee appoint one.

Senator COUZENS. I think that is true, but I think we ought to go further than that.

Senator HARRISON. If we do that, that would take care of a part of the situation.

Senator COUZENS. Yes. I differ somewhat with Senator Jones. I really believe that each of these committees, both the Ways and Means Committee of the House and the Finance Committee of the Senate, should appoint a workable committee of four or five from each committee who would act jointly in selecting these examiners and these experts to do the job. There is no necessity for both committees doing it.

The CHAIRMAN. Senator, the House amendment I think even strengthens the situation in paragraph 2. This is what they have added: "Any such committee shall have the right, acting directly as a committee or by or through such examiners or agents as it may designate or appoint, to inspect any or all of the returns at such times and in such manner as it may determine," which is what Senator Jones has already stated.

Senator HARRISON. But we have never exercised that power.

Senator COUZENS. I believe it should be mandatory. I submit that since 1913 billions and billions of dollars have been collected from the taxpayers of this country and until we started in 1924 there has never been an examination by Congress or by any committee of Congress under this statute. No one has known in the collection of all of these billions of dollars whether they have been equitably collected, whether the law has been equitably applied, whether the taxpayers have been treated with uniformity. I do not charge that anybody intentionally did anything wrong; I say that the department has had a terrific task, but I still contend that for years it has been in the most chaotic, disorganized, and inefficient condition that it was humanly possible to conceive.

Senator REED of Pennsylvania. Have you looked at the plan provided in section 1203, page 321, of the House bill for a joint commission on taxation?

Senator COUZENS. Oh, yes.

Senator REED of Pennsylvania. Is not that substantially the sort of commission or investigating body that you have in mind?

Senator CURTIS. Read it.

Senator REED of Pennsylvania. There we would have the majority representation by the appointees of Congress and five members representing the general public.

The CHAIRMAN. This is another thing that is in the bill suggested by Senator Jones.

Senator COUZENS. My opinion in reading that over, and I have not read it in the bill particularly, but I saw it in the press, is that this accomplishes nothing except perhaps the simplification of the law. In other words, I see no reason for having five members of the public. There is no reason for five members of the public going into the records and this, as I understand it, does not provide that you may go and investigate and study individual returns.

The CHAIRMAN. But section 257 does, Senator.

Senator CURTIS. I think the Senator from Michigan makes a good suggestion, that the Senate appoint a subcommittee of three and the House a subcommittee of three and they be authorized to select engineers and accountants and keep advised as to the situation and also suggest amendments and changes for the department that will simplify and make uniform their work.

The CHAIRMAN. All we would have to do would be to strike out on page 111 three words, "have the right." Then the paragraph would read:

> Any such committee shall, acting directly as a committee or by or through such examiners or agents as it may designate or appoint, inspect any or all of the returns at such times and in such manner as it may determine.

Then it would be mandatory.

Senator COUZENS. Then this committee should ask for appropriations because the very absurd suggestion of $25,000 given with which to do the job is stated. Of course, that is ridiculous. This should be a continuing body. You may not need immediately more than three or four persons, but appropriations should be provided.

The CHAIRMAN. If this law is passed then the Budget would recommend immediately an appropriation to cover it.

Senator COUZENS. The committee ought to request an appropriation the same as the department does.

The CHAIRMAN. If the law is passed it will automatically go to them.

Senator HARRISON. You have a majority of the Appropriations Committee on this Finance Committee.

Senator COUZENS. Everyone knows that there is no sanity to that provision of the law requiring the commissioner to publish those lists of taxpayers. That has resulted in the most absurd condition and it really makes the situation worse than it is.

The CHAIRMAN. Just in order that I may understand your position, if we take out the words "have the right" and make it mandatory, and an appropriation is made for this, is that what you desire?

Senator COUZENS. Yes.

Senator SIMMONS. It seems clear to me that the authority to appoint such a committee as Senator Jones has suggested and as Senator Couzens has suggested is given in the act as it now exists. It may require some little amendment such as you indicate, but that is an exercise of power for this committee. We are consuming time in discussing that when we ought to be working on this bill.

The CHAIRMAN. I thought Senator Couzens desired to make a statement. I do not want to consume any more time than is necessary.

Senator SIMMONS. I think we understand this matter.

Senator McLEAN. Outside of the salaries of these three or more experts that may be chosen, Senator Couzens, what would the expense be?

Senator COUZENS. I see no other expense. There is plenty of office room here, and I know of no other expense.

Senator McLEAN. They would not have to employ additional help, to any extent?

Senator COUZENS. No. You might have to have three or four examiners and three or four stenographers.

The CHAIRMAN. They would not be constant.

Senator COUZENS. I think they should be because nobody comprehends the task. We have had a staff down there and we have not anywhere near covered the ground.

The CHAIRMAN. You have tried to cover ground clear back to the first act.

Senator HARRISON. If you appoint two examiners, do you not think at least the minority should have the privilege of appointing one of those examiners and the majority the other?

Senator COUZENS. That is a matter for you to settle. I think both parties should be represented, but it is perfectly absurd to think that the job can be done with any two or three persons working intermittently. The task is too great.

Senator McLEAN. You said that $25,000 would not begin to cover the expense.

Senator COUZENS. No; not as provided in this act.

Senator McLEAN. Probably $25,000 would nearly cover the salaries of the three experts.

Senator COUZENS. That probably would, but have you in mind that the service would be continuous?

Senator McLEAN. Well, $25,000 a year.

Senator COUZENS. That is probably true. Of course, there would be some clerical help necessary. Roughly speaking, $50,000 a year would cover the ground with the power, of course, to call upon the department for certain information.

The CHAIRMAN. In my opinion, $25,000 would not begin to be sufficient. It would more than likely take $150,000 to $200,000 a year. I mean to do it right.

Senator JONES. It should either be done right or not be done at all.

The CHAIRMAN. That is what I have just stated.

Senator COUZENS. You can not make this examination too extensive. I mean in the interest of proper legislation and equity between taxpayers.

Senator REED of Pennsylvania. Then, Mr. Chairman, we ought to enlarge that paragraph at the bottom of page 110 so as to authorize a subcommittee.

The CHAIRMAN. We can do that when we reach that paragraph. If Senator Couzens is through——

Senator COUZENS. I do not want to be on record at this time as saying that that is all we need in the way of proper accessibility of

records. I think there is a grave misunderstanding, not only between Members of Congress but between Congress and the public and the departments as to what is meant by publicity of records. I think that Congress and everyone have gotten very much confused by a discussion of publicity of records. It is not publicity of records we need; it is accessibility of records, and if these records were accessible to proper committees of Congress, I doubt if there would be much need for anything further; but we talk about publicity, and it is not publicity we want, it is accessibility.

Senator REED of Pennsylvania. Senator Couzens, in your opinion, has the publication of these lists with the amounts of tax paid been of any assistance to the Government?

Senator COUZENS. I think not. I think it has resulted in an absurdity.

Senator HARRISON. It has gratified the curiosity of a lot of people.

Senator COUZENS. There is no necessity of that. It has not accomplished anything for Congress or the taxpayers or the Treasury Department.

Senator SIMMONS. I think we can say this, that it has not accomplished anything comparable to what will be accomplished through this investigation that you are proposing now.

The CHAIRMAN. That is in the bill.

Senator COUZENS. There is a large mass of the public that are wholly dissatisfied and discontented with the way this is operated, but you do not get that audible part of the public here.

Senator KING. I do not know that I assent to the conclusions which have been expressed by all in regard to publicity. I think it has had a wholesome effect, and, speaking for myself, I shall oppose the striking out of the publicity provision of the law.

Senator SIMMONS. I did not mean to say that it has not had a wholesome effect. I think it has. I think it has increased the amount of revenue we have collected, but I think we have reached the marrow of the matter and we have accomplished greater practical results through this commission or this committee of experts at their command than we do through the present method of publishing tax returns.

Senator COUZENS. What I meant to say in response to Senator Reed was not that the agitation had not done good; I believe it has; but as an immediate result, so far as the administration of the Treasury Department or the revenue act are concerned, I do not think it has done any good unless it has been through the agitation in bringing Congress to understand that we have to have some more practical way of securing information in the Bureau of Internal Revenue.

The CHAIRMAN. If we make this mandatory in the House provision I think we have that.

Senator JONES of New Mexico. I want to make this further suggestion, that the minority ought to have its own representation upon any such commission.

The CHAIRMAN. I can not conceive of any committee appointed by any chairman of the Finance Committee of the Senate or any chairman of the Ways and Means Committee of the House that would not have such representation.

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Senator JONES of New Mexico. I think that is true of the present committees as constituted.

Senator REED of Pennsylvania. That is a matter of course, Senator, as it would be if you were doing the appointing.

Senator KING. I would like to ask Mr. Gregg and Mr. Nash, so they will have it before them, to look into the question of the right of the Government to appeal where the decision is adverse to the Government in some of these tax cases by some subordinate organizations, because in many of these cases satisfactory conclusion is reached by the taxpayer and the commissioner and yet in many of the cases the decision may be wrong. It may be adverse to the Government and I think there should be some way by which that may be reviewed by the tax people.

The CHAIRMAN. Senator Couzens, we thank you for your presentation and the committee will now proceed with the consideration of the bill.

(The committee thereupon, at 11.30 o'clock a. m., closed its hearings on the report of the Select Committee Investigating the Bureau of Internal Revenue, and proceeded to the consideration of the bill.)

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